Supreme Court, U.S.
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In the
Supreme Court of the United States

MORDECHAI GURARY,

Petitioner,

v.

NU-TECH BIO-MED, INC.,

Respondent.

**ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT**

PETITION FOR A WRIT OF CERTIORARI

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158 P

QUESTION PRESENTED

The judgment below presents the following issue for review. This issue is an important question of federal law that has not been, but should be, settled by this Court. *See* Rule of the Supreme Court 10(c).

1. Where the Second Circuit has explicitly held that two allegations contained in a securities fraud complaint are not made to present a claim against a certain defendant, does the Private Securities Litigation Reform Act sanctions provision, 15 U.S.C. § 78u-4(c), permit that defendant to recover sanctions from plaintiff's counsel with respect to those allegations?

PARTIES TO THE PROCEEDING

In addition to the parties identified in the caption, the following was previously a party to this action:

Isaac Winehouse; and Isaac Winehouse, d/b/a Wall and Broad Equities.

This action was dismissed by the district court as against this party, which dismissal was affirmed by the Second Circuit. This party was not a party to the appeal with respect to which a writ of certiorari is now being sought, and has no interest in the issues raised in this petition.

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Gurary v. Winehouse, 2000 U.S. Dist. LEXIS 188 (S.D.N.Y. 2000).

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PETITION FOR A WRIT OF CERTIORARI

OPINIONS BELOW

This petition seeks review of the judgment of the United States Court of Appeals for the Second Circuit, *Gurary v. Winehouse*, 235 F.3d 792 (2d Cir. 2000).

STATEMENT OF JURISDICTION

The judgment which the plaintiff seeks to have reviewed was entered by the Clerk of the United States Court of Appeals for the Second Circuit on December 19, 2000.

A timely petition for rehearing was filed in the Court of Appeals for the Second Circuit. That petition was denied by order entered by the clerk of the Second Circuit on February 28, 2001.

This petition is timely since it is being brought within 90 days of the date the order denying rehearing was entered, *see* Supreme Court Rule 13(3).

Petitioner believes that this Court has jurisdiction to review on writ of certiorari pursuant to 28 U.S.C. § 1254(1).

STATUTE INVOLVED

Private Securities Litigation Reform Act, ("PSLRA"), 15 U.S.C. § 78u-4(c).

STATEMENT OF THE CASE

The petitioner is an individual investor who believed that he was the victim of a fraudulent scheme in violation of the securities laws.

The alleged scheme involved market manipulators, allegedly led by the defendant Isaac Winehouse, short selling large volumes of the stock of the defendant Nu-Tech Bio-Med, Inc. ("Nu-Tech") through the cooperation of market makers who were able, as market makers, to sell the stock short without actually having it. The short sellers were protected from the ordinary risks of short selling since they held a large number of preferred shares of Nu-Tech stock which were convertible to common stock at a very favorable price, so they were in effect selling short "against the box", and were not selling "naked" shorts. The goal was to create a "death spiral", meaning the short selling pressure would cause the bottom to drop out of the market, sending the price of the stock plummeting. This manipulation would create great

profits for the short sellers, and great losses for unfortunate investors such as the plaintiff who either owned the stock or purchased the stock during the period of the short selling.

Of course, this attempt to sell short without any risks was an improper and illegal manipulation. *See Paul F. Newton & Co. v. Texas Commerce Bank,* 630 F.3d 1111, 1113-114 (5th Cir. 1980).

The plaintiff also alleged that the defendant Nu-Tech was complicit in this scheme. Specifically, plaintiff alleged that he had personally spoken with the defendant Nu-Tech's president who promised he would thwart the short sellers by refusing to register the conversion of their convertible preferred shares into common stock. Such refusal would have negated the short sellers' risk free posture, since they would no longer have been selling short against their convertible preferred stock, and would arguably have led them to stop the short selling that was driving the stock price down. The plaintiff further alleged that Nu-Tech did not keep its president's word, and allowed the manipulators' convertible shares to be registered.

The result was a disaster. Nu-Tech stock plummeted to the vicinity of $2 per share at the time this action was commenced. The plaintiff on various dates had bought a total of 15,850 shares with a

weighted average share price of $13.13 at a total cost of $208,146. The plaintiff lost most of this investment.

The plaintiff then retained counsel and commenced this action in an effort to recoup his losses. Plaintiff asserted claims sounding in federal securities law as well as New York State law against the alleged market manipulator Winehouse, and against Nu-Tech which misled the plaintiff by registering the convertible shares after having assured the plaintiff that the convertible shares would not be registered.

This action was commenced as an individual action, not as a class action.

In a section of the plaintiff's complaint (A* 68-83) entitled "The Underlying Facts," the plaintiff listed the four transactions in which the plaintiff purchased Nu-Tech stock, as follows:

AMOUNT OF SHARES	PRICE PER SHARE	DATE OF PURCHASE
1,000	$14.60	1/31/96
5,500	$15.50	11/7/96
1,000	$11.75	12/24/96
8,350	$11.5625	2/18/97

---

* Parenthetical page references preceded by an 'A' refer to the appendix at the back of this booklet.

This listing was not part of any particular claim for relief, and was alleged as background information. Nowhere in the plaintiff's compliant did the plaintiff allege that a claim was being asserted for each of these purchases.

The defendants moved to dismiss pursuant to Fed. R. Civ. P. 12(b)(6). In their motion papers, the defendants dealt with each of the plaintiff's four purchases of Nu-Tech stock as if each were a separate cause of action arising under 17 C.F.R. § 240.10b-5.

The district court granted the defendant's motion in part, entering an order dismissing the causes of action in plaintiff's complaint arising under federal law with prejudice, and dismissing the plaintiff's state law causes of action without prejudice (A 1-9). *Gurary v. Winehouse*, 1998 U.S. Dist. LEXIS 1429, Fed. Sec. L. Rep. (CCH) P 90170 (S.D.N.Y. 1998). Four days later, the district court issued "findings" pursuant to the PSLRA, 15 U.S.C. § 78u-4(c), in which the district court found that:

> the claims and arguments made in the complaint, the motions to dismiss and the papers in opposition to the motions to dismiss were "warranted by existing law or by a nonfrivolous argument for the extension, modification, or renewal of

> existing law or the establishment of new law," Fed. R. Civ. P. 11(b)(2), were not "presented for any improper purpose," Fed. R. Civ. P. 11(b)(1), and complied with Rule 11(b) of the Federal Rules of Civil Procedure.

Gurary v. Winehouse, unpublished memorandum decision dated February 17, 1998.

The plaintiff then appealed the dismissal, and the defendant Nu-Tech cross-appealed from the district court's finding that the complaint complied with Fed. R. Civ. P. 11 and its denial of sanctions. The defendant Winehouse did not appeal.

The Second Circuit affirmed the dismissal of the complaint. *Gurary v. Winehouse,* 190 F.3d 37 (2d Cir. 1999) (hereinafter *"Gurary I"*). As will be discussed further below, that decision specifically noted that the claims against Nu-Tech were limited to the second two purchases, and that no claim was made against Nu-Tech with respect to the first two purchases. *Id.*, 190 F.3d at 44 (A 24).

On the issue of the PSLRA requirement that the district court review the complaint and render "findings" as to compliance with Rule 11, the Second Circuit concluded as follows:

> Although the judgment implicitly denied Nu-Tech's motion, the district court made no

> findings regarding compliance with Rule 11(b). As the statute required the district court to make findings, we have no choice but to remand in order to permit it to do so.

Gurary I, 190 F.3d at 47, (A 33). Thus, it appeared that the Second Circuit may have overlooked the district court's findings quoted above, which were not part of the order granting the motion to dismiss.

On remand, the district court declined to presume that the Second Circuit had erred. The court wrote:

> My order dated February 17, 1998, finding no justification for the imposition of sanctions, was part of the joint appendix on appeal and was cited in Nu-Tech's June 15, 1998 brief (p. 34) to the Court of Appeals. Accordingly, I do not assume that Court was unaware of my order, but rather take that Court's statement (190 F.3d 37 at 47) that I "made no findings regarding compliance with Rule 11(b)" as meaning that it regarded my findings as merely formalistic.

Gurary v. Winehouse, 2000 U.S. Dist. LEXIS 188 (S.D.N.Y. 2000) (A 35-36). The district court then again concluded, this time with discussion and analysis, that the complaint was not frivolous, that Rule 11 had not been violated, and that sanctions would not be granted.

Once again the defendant Nu-Tech appealed and argued to the Second Circuit that the complaint was frivolous and in violation of Rule 11, and that sanctions were required by the PSLRA.

This second appeal was heard by a different panel of the Second Circuit. *Gurary v. Winehouse*, 235 F.3d 792 (2d Cir. 2000) (hereinafter "*Gurary II*").

In *Gurary II*, the Second Circuit concluded that the plaintiff's complaint was partially frivolous and partially not frivolous. The *Gurary II* court treated the complaint as if it alleged four separate federal securities law claims, one for each of the purchases, and then, having thus unnaturally parsed the complaint, found that the plaintiff's "claims" arising from the first two purchases of Nu-Tech stock (October 31, 1996 and November 7, 1996) were frivolous, while the claims arising from the second two purchases (December 24, 1996 and February 18, 1997) were not frivolous and could have been pleaded so as to state a viable claim, even though they had been dismissed and leave to amend the complaint had been implicitly denied. The Second Circuit then remanded this case "for the district court to determine appropriate sanctions pursuant to 15 U.S.C. § 78u-4(c)(3)(A)-(C)," *Gurary II*, 235 F.3d at 800 (A 59), with respect to the claims arising from the first two purchases that had been deemed "frivolous."

The opinion in *Gurary II* that sanctions are warranted with respect to the first two purchases is disturbingly incongruous, since in *Gurary I* another panel of the Second Circuit had found that:

> Plaintiff's attack on the dismissal of his Rule 10b-5 claim against Nu-Tech is limited to the claim that he was deceived in making his December 24, 1996 and February 18, 1997 purchases because he relied upon Feigenbaum's declarations that Nu-Tech would not register the common into which the Winehouse group's preferred was convertible and that this should or would stop it from selling the common short.

Gurary I, 190 F.3d at 44 (A 24) (emphasis added). The finding of the panel in *Gurary II* that plaintiff's counsel must be sanctioned for having asserted claims that the panel in *Gurary I* had found that the plaintiff was not asserting is simply inexplicable.

REASONS FOR GRANTING THE WRIT

A DEFENDANT MAY NOT RECOVER SANCTIONS UNDER PSLRA § 130, 15 U.S.C. § 78U-4(c), FOR FRIVOLOUS CLAIMS NOT ASSERTED AGAINST THAT DEFENDANT.

The two opinions issued by the Second Circuit in this case, *Gurary I* and *Gurary II*, leave this petitioner and all plaintiffs in securities actions in a paradox, as *Gurary II* held that petitioner's counsel must pay sanctions to the defendant Nu-Tech for supposedly having asserted claims that *Gurary I* recognized were not asserted against the defendant Nu-Tech. This bizarre dichotomy will have an *in terrorem* effect that will prevent lawyers whose clients have valid securities fraud claims from filing meritorious complaints for fear of having to pay sanctions awards even to parties against whom they have made no frivolous allegations.

Gurary II concluded that sanctions were warranted with respect to "the claims arising out of Gurary's first two purchases" *Gurary II*, 235 F.3d at 800 (A 59). Implicit in this conclusion is the premise that Gurary's complaint asserted claims arising out of the first two purchases. Yet no such allegation was contained in the complaint, a copy of which is annexed hereto as part of the Appendix (A 68-83).

The complaint mentions particular purchases of Nu-Tech stock only in one paragraph, paragraph 13, which is contained in the preliminary section of the complaint entitled "The Underlying Facts." In that paragraph, Gurary sets forth, simply by way of background, the date, number of shares and price per share for each of Gurary's four purchases of Nu-Tech stock. Nothing in paragraph 13 suggests that Gurary intended to make a separate claim for each of those four purchases.

Later in the complaint, Gurary alleges that there was a fraudulent scheme orchestrated by the Winehouse defendants with Nu-Tech's knowledge, that Nu-Tech had failed to reveal the existence of the scheme, and that Nu-Tech had promised not to register certain stocks to defeat the fraudulent scheme and to prevent it from being successful.[1]

Gurary's affidavit was submitted in opposition to the defendants' Fed. R. Civ. P. 12(b)(6) motions in order to further particularize the claims asserted. A

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[1] Nu-Tech's promise not to register the short sellers' shares is alluded to in paragraph 47 of the complaint and is greatly expanded upon in the plaintiff's affidavit submitted in opposition to the defendant's Fed. R. Civ. P. 12(b)(6) motion (Gurary affidavit, A 84-95).

copy of that affidavit is also part of the Appendix (A 84-95). As the Court can see, Gurary sets forth a detailed history of his purchases of Nu-Tech stock, the information he had gathered regarding the fraud, and the promise made to Gurary by Nu-Tech's president that Nu-Tech would attempt to defeat the Winehouse scheme by refusing to register the short seller's converted shares. The fraudulent conduct described in the affidavit is alleged to have taken place between December 1996 and April 1997. The clear gist of the affidavit, taken together with the allegations of the complaint, is that the plaintiff intended to assert a claim arising from this fraudulent activity only.

Any references in the complaint or the affidavit to purchases of Nu-Tech shares pre-dating the fraudulent scheme are offered by way of background to demonstrate that the plaintiff was a legitimate investor whose interest in this stock pre-dated the fraud, rather than the sort of faux investor against whom the PSLRA was aimed, the sort who seeks to generate lawsuits by buying stock in speculative companies in order to then bring a lawsuit when the share price declines.

Similarly, in the memorandum of law submitted by Gurary's counsel to the district court in opposition to the defendants' Rule 12(b)(6) motions, and particularly in the section of that memorandum of law

addressing the defendant Nu-Tech's motion, Gurary's counsel made it clear that the essence of Gurary's claim involved the latter two purchases. For example, the memorandum of law stated:

> Since the complaint clearly alleges that by December 1997 Nu-Tech and its president, Mr. Feigenbaum, were aware of the Weinhouse group's activities and, in fact, had withdrawn the registration of the Series A convertible Preferred Stock because of the short-selling activities, and that Mr. Feigenbaum had met with Mr. Winehouse at Nu-Tech's office in an attempt to stop the short-selling, it is crystal clear that at least the 8,350 shares purchased by the plaintiff on February 18, 1997 for 11 9/16 per share, as well as the purchase on December 24, 1996 of 1,000 shares at 11 ¾ were done *after* Mr. Feigenbaum was aware of the Winehouse group's short sales and he had an obligation to reveal this highly critical information to the investing public, including the plaintiff.

Plaintiff's Memorandum of Law in Opposition to the Defendants' Motions to Dismiss (A 96-123) (italics in original).

After the district court dismissed the complaint, Gurary appealed (*Gurary I*). In Gurary's reply brief (A 124-41) responding to the defense argument that the

first two trades were outside the period during which the alleged fraud occurred, Gurary argued as follows:

> It is the plaintiff's contention that the Winehouse defendants started manipulating the stock once they knew they would be able to obtain Nu-Tech stock at no more than three quarters of its price as a result of becoming owners or potential owners of the Series A convertible preferred stock. In fact, plaintiff alleges that the original filing with the SEC to register the Series A convertible preferred stock was withdrawn by the company in December 1996 because of the Winehouse group's short-selling and by December 1996 plaintiff had already called Nu-Tech's president Feigenbaum to complain that the price was declining because of apparent short-selling by the Winehouse group. The exact dates that the Winehouse group began shorting the stock through various nominees is of course unknown to the plaintiff at this point because no discovery was ever had.
>
> Assuming that for purposes of the motion to dismiss one must adopt the initial issue date as November 6, 1996 as alleged, and assuming it was December 2, 1996 that the deal was finally completed, this does not mean that the Winehouse defendants could not have started and in fact did not start to

> short Nu-Tech stock prior to that date once members of the group, the identities of whom have not yet been ascertained although the purported investors are set forth, began shorting the stock prior to that date.
>
> With respect to the plaintiff's subsequent purchases on December 24, 1996 and on February 18, 1997, the Winehouse defendants argue that at the time plaintiff knew of the fraudulent scheme and therefore has no case. In fact, the record is to the contrary; that plaintiff only purchased additional shares on December 24, 1996 and February 18, 1997 after he had been assured by Nu-Tech's president that Nu-Tech would not register the Series A convertible stock unless the Winehouse group stopped shorting the stock. Plaintiff had an absolute right to rely on the representations made to him by the president of Nu-Tech that the company would not participate in the Winehouse group's manipulative scheme.

Gurary I Reply Brief (A 133-34) (references to joint appendix submitted to the Second Circuit omitted).

As the Court can see, in arguing *Gurary I* the plaintiff continued to place the emphasis on the second two purchases as the basis of his claim. It is true that in the reply brief Gurary did articulate the possibility that

discovery might reveal that the share price of one or both of the first two purchases may have also been impacted by the defendants' fraud, and Gurary did suggest that the issue of whether claims regarding those purchases were viable should wait until after discovery. But the clear emphasis of the argument was that the second two purchases were the basis of the claim.

Indeed, as mentioned earlier in this petition, in deciding *Gurary I*, the Second Circuit specifically noted that the:

> Plaintiff's attack on the dismissal of his Rule 10b-5 claim against Nu-Tech is limited to the claim that he was deceived in making his December 24, 1996 and February 18, 1997 purchases[2] because he relied upon Feigenbaum's declarations that Nu-Tech would not register the common into which the Winehouse group's preferred was convertible and that this should or would stop it from selling the common short.

Gurary I, 190 F.3d at 800 (A 59) (emphasis and footnote added).

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[2] These are the last two purchases. The *Gurary II* court found that the allegation of claims arising from these two purchases was not frivolous.

Thus, the record demonstrates that notwithstanding the listing of four separate purchases of Nu-Tech stock as general background under the heading "The Underlying Facts" in paragraph 13 of the complaint, it was at all times the Gurary's intention to focus his claim on the second two purchases.

Had this case proceeded, interrogatories and other discovery demands presumably would have been served and the exact claims would have been particularized in the responses. Petitioner's counsel should not have been penalized with sanctions for having provided more than the absolute minimum detail in the complaint.

By sanctioning petitioner's counsel, the Second Circuit's decision in *Gurary II* will have an undesirable *in terrorem* effect encouraging lawyers not to bring securities fraud cases at all for fear of sanctions, and also not to include detail and background information in their pleadings, which would essentially be an undesirable regression back to the old-style uninformative vague boilerplate that is otherwise discouraged by the Federal Rules of Civil Procedure.

The Second Circuit's decision in *Gurary II* presupposed that the Gurary had asserted four separate claims for each of his four purchases of Nu-Tech stock, and that Gurary had made specific claims against Nu-

Tech arising from these first two purchases. Yet *Gurary I* had already found that the petitioner was not asserting a claim against Nu-Tech with respect to those transactions. The presupposition relied upon by the Second Circuit in *Gurary II* is contrary to what the Second Circuit held in *Gurary I*, and was further plainly based on a misapprehension of the complaint.

The finding in *Gurary II* that the petitioner's counsel should be sanctioned for having asserted claims against the defendant Nu-Tech that *Gurary I* had already found were not being asserted, and which an objective review of the papers filed in this action shows were not being asserted, is indefensible. The PSLRA certainly does not require that attorneys pay sanctions to defendants in securities fraud cases for claims that were not asserted against such defendants. Yet that is exactly what *Gurary II* did.

Unless reviewed by this Court, *Gurary II* will be invoked by the Bench and Bar as requiring that securities fraud complaints be microscopically scrutinized to find "frivolous" statements or allegations that perhaps exist only at the molecular level just so that sanctions can be imposed. This was never intended by Congress in enacting the PSLRA and is not fair to lawyers who earn their livelihoods practicing in this area of law, including petitioner's counsel.

Such an emphasis on sanctions awards will lead to a proliferation of sanctions demands in every securities case, which is exactly the sort of "second major litigation" over attorneys fees and sanctions that this Court has previously looked upon with disfavor. *Hensley v. Eckerhart*, 461 U.S. 424, 437 (1983).

CONCLUSION

For the reasons set forth herein, petitioners respectfully request that this Court grant a writ of certiorari to the United States Court of Appeals for the Second Circuit.

Dated: New York, New York
May 24, 2001

Respectfully submitted,

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Appendix

Decision And Order Of The District Court Dated February 10, 1998 Dismissing Plaintiff's Complaint

UNITED STATES DISTRICT COURT

FOR THE SOUTHERN DISTRICT OF NEW YORK

MORDECHAI GURARY,

Plaintiff,

-against-

ISAAC WINEHOUSE d/b/a WALL & BROAD EQUITIES and NU-TECH BIO-MED, INC,

Defendants.

97 Civ. 3803 (LLS)

February 9, 1998, Decided
February 10, 1998, Filed

LOUIS L. STANTON, U.S.D.J.:

Mr. Gurary sues Isaac Winehouse and Isaac Winehouse d/b/a Wall & Broad Equities under § 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), and Rule 10b-5 promulgated thereunder, as well as § 349 of New York General Business Law, claiming

he was injured by a scheme to manipulate the market for shares of Nu-Tech Bio-Med, Inc. ("Nu-Tech"). He sues Nu-Tech under the same laws, claiming that Nu-Tech knew of the scheme but did not disclose it. He seeks to enjoin Nu-Tech, pending the determination of this action, from registering the Convertible Stock referred to below. Defendants move to dismiss all claims.

Plaintiff alleges that in November of 1996, Nu-Tech privately issued 14,000 shares of "Series A Convertible Preferred Stock" for a total price of $14 million. Compl. ¶¶ 16, 21. The stock was convertible, at a later date, into common stock at the lesser of $17.50 per share or 75% of the average closing price for the five trading days prior to conversion. Compl. ¶ 19. Plaintiff claims that Winehouse and "other members of his cartel" arranged to buy a large part of the Convertible Stock using the names "of other nominees who were not really the owners of the stock." Compl. ¶ 23. He alleges that the Winehouse cartel then began selling the stock short using various accounts to conceal the identities of its members. Compl. ¶ 26. Their purpose was to manipulate the market and drive down the price of Nu-Tech shares. Compl. ¶ 40.

Plaintiff says that in December of 1996, Marvin Feigenbaum, the Chairman of Nu-Tech, found out

about Winehouse's scheme and called Winehouse demanding that he stop, or that Nu-Tech would not permit the registration of the Convertible Stock to become effective. Compl. ¶¶ 27-28. Although the stock price did not drop over the next two months, the short sales continued and at a meeting on February 18, 1997, Feigenbaum proposed that Winehouse stop his activities in exchange for a 10% profit on the amount paid for the Convertible Stock "and that the short sellers would be permitted to keep their profits." Compl. ¶ 29. Winehouse rejected the offer and stated that he would continue his short-selling. Compl. ¶ 34. Over the next two days, the price of the stock dropped approximately six dollars per share. Compl. ¶ 35. Plaintiff alleges that as a result of the cartel's fraudulent conduct, he purchased Nu-Tech stock at artificial prices and incurred substantial losses. Compl. ¶ 42. He also claims that for failing to notify the public of Winehouse's scheme, Nu-Tech's conduct "constituted fraud with respect to concealing material information and providing misinformation." Compl. ¶ 49.

Gurary's suit is based on four Nu-Tech purchases, two of which he made before the cartel allegedly started manipulating the market. Compl. ¶¶ 13, 16, 24.

Dealing with those trades first, the plaintiff cannot rest a claim on the two purchases completed before the short-selling began, because the scheme was not "in connection with" those purchases. "Where the only manipulative or deceptive acts identified in a complaint occur after a challenged securities purchase or sale, a court must dismiss the complaint as failing to state a cause of action for federal securities fraud." *Samuel M. Feinberg Testamentary Trust v. Carter*, 652 F. Supp. 1066, 1080 (S.D.N.Y. 1987). The prices paid for his first two purchases were unaffected by the claimed manipulation.

The claims regarding plaintiff's last two purchases of stock (which took place during the alleged manipulation) fail for lack of reliance upon any but the true picture. In response to defendants' motions to dismiss, Gurary submitted his affidavit stating:

> When Nu-Tech stock started to decline, I, as other shareholders of Nu-Tech, became concerned. I personally spoke to Marvin Feigenbaum, the president of Nu-Tech, in or about December, 1996—I do not recall the exact date—and he advised me that he had spoken to Isaac Winehouse, the defendant in this case, as well as to Mr. Winehouse's counsel, Heller, Horowitz & Feit, P.C. and alerted them that if the Winehouse group did

not stop shorting Nu-Tech stock, he would withdraw the registration of those shares so that the group, rather than being assured of a locked-in profit, would have to buy the stock in the open market at possibly higher prices and that this would convince them not to continue shorting the stock.

I continued to buy Nu-Tech stock, buying one thousand shares on December 24, 1996 at 11-3/4.

Affidavit of Mordechai Gurary, sworn to August 20, 1997, at p. 3. Gurary testifies about his final purchase:

On or about February 18, 1997, I again spoke to Marvin Feigenbaum, president of Nu-Tech, who advised me that a meeting had been held that day at Nu-Tech's offices [with Mr. Winehouse].

At the meeting on February 18, 1997, Mr. Feigenbaum had requested Mr. Winehouse and his group, which members Mr. Winehouse refused to identify, to stop shorting Nu-Tech stock [in exchange for the 10% premium and retaining of profits explained earlier in this opinion]...

According to Mr. Feigenbaum, Mr. Winehouse refused to agree to this but instead advised Mr. Feigenbaum that it was not to Mr. Winehouse's personal benefit to

> resolve the dispute on those terms and he would see to it that Mr. Feigenbaum did not have a future in the company--because his options at $7 and $11.50 would be worthless, to which Mr. Feigenbaum responded that, if necessary he would get his option plan reissued at $1. Mr. Winehouse also said he would see to it that the price of Nu-Tech stock would fall significantly.
>
> Mr. Feigenbaum further advised me that the Board of Directors had designated Robert Fagenson and one other Board member to negotiate with Mr. Winehouse and the Reg. D holders.
>
> Mr. Feigenbaum further advised me that the company would not give in to Mr. Winehouse's blackmail and would refuse to register the short-sellers' shares.
>
> I then purchased another 8,350 shares of Nu-Tech stock on February 18, 1997 at 11-9/16.

Id., at ¶¶. 4-5.

Mr. Gurary does not claim that any of Mr. Feigenbaum's statements to him were false when they were made. Gurary was fully informed by Feigenbaum and cannot rely on any omission by Nu-Tech in connection with the purchase of those securities. Nor can plaintiff's claims succeed on a "fraud on the

market" theory, because while there is presumption of reliance, defendants may show:

> that an individual plaintiff traded or would have traded despite his knowing the statement was false. Any showing that severs the link between the alleged misrepresentation and either the price received (or paid) by the plaintiff, or his decision to trade at a fair market price, will be sufficient to rebut the presumption of reliance.

Basic Inc. v. Levinson, 485 U.S. 224, 248, 108 S. Ct. 978, 992, 99 L. Ed. 2d 194 (1988). Here, the link is severed because plaintiff "actually knew the information that was not disclosed to the market." *Fine v. American Solar King Corp.*, 919 F.2d 290, 299 (5th Cir. 1990) (citing *Basic Inc.*, 485 U.S. at 248, 108 S. Ct. at 992). Defendants are awarded summary judgment dismissing the securities fraud claims.[1]

Plaintiff's remaining claims are based on N.Y. Gen. Bus. Law § 349. The general rule is that where "all federal-law claims are eliminated before trial, the balance of factors to be considered under the pendent

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[1] I express no opinion concerning the availability or merit of any other relief, through private or regulatory agency action, concerning the short-sale transactions.

jurisdiction doctrine...will point toward declining to exercise jurisdiction over the remaining state-law claims." *Carnegie-Mellon Univ. v. Cohill*, 484 U.S. 343, 350 n.7, 108 S. Ct. 614, 619 n.7, 98 L. Ed. 2d 720 (1988). The state claims are therefore dismissed without prejudice.

Since no claims remain in this court, the application for an injunction *pendente lite* is denied.

CONCLUSION

Defendants' motion is granted. The application for an injunction is denied. The Clerk will enter judgment dismissing the complaint, without prejudice to plaintiff's state-law claims.

So ordered.

Dated: New York, New York
February 9, 1998

S/
LOUIS L. STANTON
U.S.D.J.

Decision Of Second Circuit In Gurary I Affirming Dismissal And Remanding For PSLRA Findings Of Compliance With Rule 11

Nos. 98-7239(L), 98-7280(XAP)

MORDECHAI GURARY

Plaintiff-Appellant-Cross-Appellee,

v.

ISAACWINEHOUSE and ISAAC WINEHOUSE, doing business as Wall & Broad Equities,

Defendant- Appellee

v.

NU-TECH BIO-MED, INC.

Defendant- Appellee-Cross-Appellant.

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK

ARGUED OCTOBER 6, 1998

DECIDED AUGUST 24, 1999

OPINION OF THE COURT

Before: WALKER, Circuit Judge, OAKES, Senior Circuit Judge, and KAPLAN, District Judge. *

* Honorable Lewis A. Kaplan, United States District Judge for the Southern District of New York, sitting by designation.

KAPLAN, District Judge:

Plaintiff appeals from a judgment of the district court (Stanton, J.) to the extent that it dismissed the plaintiff's claims under Section 10(b) of the Securities and Exchange Act of 1934 (the "Exchange Act"), 15 U.S.C. § 78j, and Rule 10b-5 thereunder on the merits and his pendent state claims for lack of subject matter jurisdiction. One of the defendants cross-appeals from so much of the judgment as denied so much of its motion as sought sanctions under the Private Securities Litigation Reform Act of 1995 (the "PSLRA"). We affirm so much of the judgment as dismissed plaintiff's case. We vacate and remand insofar as it denied the application for sanctions.

I

Nu-Tech Bio-Med, Inc.("Nu-Tech") was formed in 1981. Its common stock, which is the security that allegedly was manipulated, is traded on NASDAQ.

THE NU-TECH CONVERTIBLE PREFERRED

In late 1996,[1] at a time when Nu-Tech common stock was trading at about $15 per share, Nu-Tech raised $14 million by issuing 14,000 shares of Series A Convertible Preferred Stock in a private placement at a price of $1,000 per share. This security had no voting rights and paid no dividends but was convertible into common at the lesser of (1) $17.50 per share, and (2) 75 percent of the average closing bid price of the common for the five trading days prior to the date of the holder's notice of conversion, with one-third of the holder's shares being convertible on each of the forty-fifth, the seventy-fifth, and the one hundred-fifth day after issuance. Nu-Tech was obliged to register the common stock into which the preferred was convertible. These characteristics had several notable implications.

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[1] The complaint alleges that the initial issue date was November 6, 1996. A registration statement for a subsequent sale of common stock states that the placement was completed on December 2, 1996.

First, the facts that the preferred (a) paid no dividends, (b)had no voting rights, and (c) was convertible to common at a bargain price, and that (d) the conversion right expired following the one hundred fifth day following issuance meant that the preferred almost inevitably would be converted.[2]

Second, purchasers of the preferred were likely to profit no matter what happened to the price of the common stock, provided only that the company survived. If the common traded below $23.33 per share immediately prior to conversion, the preferred would be converted at 75 percent of the price of the common (which would be less than $17.50). As long as the price of the common did not fall more than 25 percent following the conversion, the preferred shareholder would profit by conversion and sale of the common into which the preferred was converted.[3] If the common traded above $23.33 immediately prior to conversion, the preferred would be converted at $17.50 (which

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[2] In addition, Nu-Tech had the right to force conversion commencing 270 days following the completion of the private placement.

[3] For example, if the common continued to trade at its preconversion price, but at any price below $23.33, the preferred shareholder would gain a constant $333.33 per share by converting and selling the newly issued common.

would be less than 75 percent of the trading price of the common), thus virtually assuring an even greater profit.

Third, even if the preferred were to be converted into the minimum number of common shares,[4] the preexisting common stock holders would be diluted very substantially. At the minimum conversion ratio of 57.14 shares of common per share of preferred, conversion of the entire issue of preferred would result in the issuance of 799,970 additional shares of common, whereas Nu-Tech had only about 2.4 million shares outstanding at the time of the private placement. Conversion at higher ratios (i.e., when the price of the common was below $23.33 per share) would increase the number of shares issued and therefore the dilution. Indeed, a sufficiently substantial drop in the price of the common could increase the conversion ratio so much that conversion would result in the former preferred shareholders owning a majority of the company's post-conversion common stock. Thus, the existence of the convertible preferred, in and of itself, doubtless exerted downward pressure on the price of the common.

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[4] The conversion price of the lower of $17.50 or 75 percent of the trading price of the common meant that the number of

(continued next page)

WINEHOUSE'S ALLEGED SCHEME

The complaint alleges that defendant Isaac Winehouse, doing business as Wall & Broad Equities, organized a "cartel" to purchase a percentage of the Nu-Tech convertible preferred in the names of nominees. He then allegedly arranged for a number of securities firms to become market makers in Nu-Tech common stock and proceeded to sell the common short, allegedly to drive the price of the common stock down.

THE DEALINGS AMONG NU-TECH, WINEHOUSE AND PLAINTIFF

Plaintiff Mordechai Gurary purchased 1,000 shares of Nu-Tech common on October 31, 1996 and another 5,500 shares on November 7, 1996 at $14.60 and $15.50 per share, respectively. In or about December 1996, the stock price began to decline. A concerned Gurary spoke to J. Marvin Feigenbaum, chairman of Nu-Tech. Feigenbaum told him that he had spoken to Winehouse and threatened that Nu-Tech would refuse to register the common stock into which the preferred was convertible unless Winehouse and his group stopped shorting the common. He predicted that this

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shares into which each share of preferred was convertible could not fall below 57.14.

threat would convince Winehouse to stop shorting the stock because a refusal to register the common issued upon conversion would force Winehouse to cover his short position by purchasing Nu-Tech common in the open market, perhaps at higher prices. Gurary, evidently comforted, then purchased another 1,000 shares on December 24, 1996 at a price of $11.75 per share.

Gurary claims subsequently to have learned that Winehouse and his associates had continued to short the stock using nominee names, having arranged to "borrow" an unlimited number of shares for that purpose from market makers. On February 18, 1997, Gurary again spoke to Feigenbaum, who told him that he had met that day with Winehouse and others in another attempt to stop the short selling. Feigenbaum told Gurary that Nu-Tech had offered to repurchase the group's preferred shares at cost plus ten percent and to allow it to keep its existing profits from the short sales if the group would stop its activities but that Winehouse had refused. Feigenbaum, however, told Gurary that Nu-Tech would not give in to Winehouse and would refuse to register the short sellers' shares. Later that day, Gurary bought another 8,350 shares of Nu-Tech common at a price of $11.57.

On March 12, 1997, Feigenbaum and another Nu-Tech board member met again with Winehouse and asked that Winehouse and his group accept registration of the common stock into which their preferred was convertible over a period of twelve months rather than insisting that it be registered immediately. Winehouse again refused and said that he would continue to sell short.

Nu-Tech common stock dropped approximately $6 per share over the next two days. On March 14, 1997, the company issued a press release which stated that the price decline could be attributed to "possible sales by shareholders." No mention was made of the discussions between Nu-Tech and Winehouse, allegedly to avoid disrupting Nu-Tech's efforts to acquire Physicians Clinical Laboratory, Inc. ("PCL") out of bankruptcy.

A few days later, Gurary was approached through an intermediary and spoke with Winehouse, who allegedly admitted to him that he deliberately had shorted the stock to drive the price down, said that he intended to continue, and advised Gurary to sell his shares because the price would drop to "a dollar."

PROCEEDINGS BELOW

Plaintiff commenced this action against Nu-Tech and Winehouse on May 23, 1997. The complaint contains three relevant claims for relief.[5] The first charges Winehouse with manipulation of Nu-Tech's common stock in violation of Section 10(b) of the Exchange Act, 15 U.S.C. § 78j, and Rule 10b-5 thereunder, 17 C.F.R. § 240.10b-5, by the purchase of the convertible preferred and the shorting of the common.[6] The second claim is against Nu-Tech and charges a 10b-5 violation in that Nu-Tech, motivated by a desire to avoid having Winehouse and other short

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[5] The fourth claim for relief sought a preliminary injunction barring Nu-Tech from registering the convertible preferred pending the determination of the action. Plaintiff, however, never moved for a preliminary injunction. Moreover, the complaint alleges that the convertible preferred was issued in December 1996 in a private placement subject to Regulation D under the Securities Act of 1933, 15 U.S.C. § 77a et seq. (the "Securities Act"). In consequence, the issuance of the convertible preferred was exempt from registration. 15 U.S.C. § 77d(2); 17 C.F.R. §§ 230.501-08 (1998).

[6] It charges also that "the defendants made numerous misstatements of material facts and omissions to state material facts necessary in order to make statements not misleading." As it does not identify any such misstatements or omissions in the first claim for relief, this aspect of the complaint fails to comply with FED. R. CIV. P. 9(b) and may be disregarded.

sellers object to its effort to acquire certain debt securities of PCL in a transaction requiring bankruptcy court approval, "failed to reveal the sale to Winehouse and his group through the use of nominees, that there were meetings going on between Winehouse and his group and Nu-Tech; that Nu-Tech was aware of the short-selling by Winehouse and his group; [and] that Nu-Tech would refuse to register certain stocks due to the short-selling activities of Winehouse and his group..." In addition, it charges that Nu-Tech's March 14, 1997 press release was misleading for failure to disclose Winehouse's short sales and the discussions between Nu-Tech and Winehouse. The third claim for relief alternatively seeks recovery from both defendants under Section 349 of the New York General Business Law.

Both defendants moved to dismiss the complaint for failure to state a claim upon which relief may be granted. Gurary opposed the motions and submitted a nine page affidavit in which he recounted his conversations with Messrs. Feigenbaum and Winehouse in greater detail than was included in the complaint. His attorney also submitted an argumentative affidavit that claimed no personal knowledge of anything relevant to the case, but that

suggested that Winehouse had violated Section 5 of the Securities Act, 15 U.S.C. § 77e.

In disposing of the motions, Judge Stanton specifically relied upon Gurary's affidavit, thus converting them into motions for summary judgment pursuant to Rule 12(b). He noted that the case was based on four purchases of Nu-Tech common stock by Gurary, two of which preceded the alleged commencement of the short selling and the other two of which were made after Gurary learned of the short sales from Feigenbaum. He therefore dismissed the Rule 10b-5 claim against Winehouse with respect the first pair of purchases on the ground that Winehouse's allegedly manipulative short sales were not made "in connection with" those purchases. He dismissed the 10b-5 claim based on the second pair of purchases on the ground that plaintiff's knowledge of the facts defeated any claim "of reliance upon any but the true picture." He dismissed the Rule 10b-5 claim against Nu-Tech because the complaint failed to allege that any of Feigenbaum's statements to plaintiff was false when made. Having held the federal claims insufficient, Judge Stanton dismissed the state law claims for lack of subject matter jurisdiction. Judgment was entered accordingly.

Plaintiff appeals from the judgment. Nu-Tech cross-appeals insofar as the district court failed to grant sanctions against plaintiff pursuant to the PSLRA, 15 U.S.C. § 78u-4 et seq.

II

Plaintiff argues first that the district court erred by considering his own affidavit and thus converting the motions into motions for summary judgment. Having done so, he contends, the court erred further by deciding them without giving the plaintiff an opportunity to conduct discovery.

CONVERSION OF THE MOTION

Rule 12(b) provides in relevant part:

> "If, on a motion asserting the defense numbered (6) to dismiss for a failure of the pleading to state a claim upon which relief can be granted, matters outside the pleading are presented to and not excluded by the court, the motion shall be treated as one for summary judgment and disposed of as provided in Rule 56, and all parties shall be given reasonable opportunity to present all material made pertinent to such a motion by Rule 56."

We frequently have held that a district court ordinarily must give notice to the parties before converting a motion to dismiss pursuant to Rule 12(b)(6) into one for summary judgment and considering matters outside the pleading. *E.g., Kopec v. Coughlin,* 922 F.2d 152, 154-55 (2d Cir. 1991). This is simply an application, however, of the principle that parties are entitled to a reasonable opportunity to present material pertinent to a summary judgment motion. Hence, "compliance...is not an end in itself. * * * The essential inquiry is whether the appellant should reasonably have recognized the possibility that the motion might be converted into one for summary judgment or was taken by surprise and deprived of reasonable opportunity to meet facts outside the pleadings." *In re G. & A. Books, Inc.,* 770 F.2d 288, 295 (2d Cir. 1985), cert. denied sub nom. *M.J.M. Exhibitors, Inc. v. Stern,* 475 U.S. 1015, 89 L. Ed. 2d 310, 106 S. Ct. 1195 (1986).

In this case, it was plaintiff who submitted the affidavit relied upon by the district court and who thus invited Judge Stanton to rely not only on the complaint, but upon the more elaborate explication of plaintiff's grievance contained in his affidavit. He certainly cannot be heard to claim that he was surprised when the district court accepted his invitation. Indeed, the district

court arguably would have erred in declining to do so. *See Freeman v. Marine Midland Bank,* 494 F.2d 1334, 1338-39 (2d Cir. 1974) (error to disregard affidavits submitted by plaintiff in opposition to a motion to dismiss). In consequence, the motions properly were converted.

RULE 56(f)

Plaintiff's claim that the court below erred in deciding the motions without giving him an opportunity to conduct discovery also lacks merit.

Rule 56(f) provides:

> "Should it appear from the affidavits of a party opposing the motion that the party cannot for reasons stated present by affidavit facts essential to justify the party's opposition [to a motion for summary judgment], the court may refuse the application for judgment or may order a continuance to permit affidavits to be obtained or depositions to be taken or discovery to be had or may make such other order as is just."

Thus, as we often have said, a party resisting summary judgment on the ground that it needs discovery in order to defeat the motion must submit an affidavit showing "'(1) what facts are sought [to resist the motion] and how they are to be obtained, (2) how

those facts are reasonably expected to create a genuine issue of material fact, (3) what effort affiant has made to obtain them, and (4) why the affiant was unsuccessful in those efforts.'" *Meloff v. New York Life Ins. Co.*, 51 F.3d 372, 375 (2d Cir. 1995) (quoting *Hudson River Sloop Clearwater, Inc. v. Department of Navy*, 891 F.2d 414, 422 (2d Cir. 1989)); accord, *Paddington Partners v. Bouchard*, 34 F.3d 1132, 1137-38 (2d Cir. 1994); *Burlington Coat Factory Warehouse Corp. v. Esprit De Corp.*, 769 F.2d 919, 926 (2d Cir. 1985). Indeed, the failure to file such an affidavit is fatal to a claim such as plaintiff makes here even if the party resisting the motion for summary judgment alluded to a claimed need for discovery in a memorandum of law. *Paddington Partners*, 34 F.3d at 1137.

The affidavits plaintiff submitted in the district court did not contend that any discovery was required to meet the defendants' motions, let alone satisfy the test articulated most recently in *Meloff*. Indeed, plaintiff did not even hint below at any need for discovery in order to resist defendants' motions. In consequence, the court below plainly did not err in passing on the merits of the motions in the absence of any discovery.

III

Plaintiff's attack on the dismissal of his Rule 10b-5 claim against Nu-Tech is limited to the claim that he was deceived in making his December 24, 1996 and February 18, 1997 purchases because he relied upon Feigenbaum's declarations that Nu-Tech would not register the common into which the Winehouse group's preferred was convertible and that this should or would stop it from selling the common short.[7] But this argument too is without merit.

To begin with, this theory is not the basis of the Rule 10b-5 claim against Nu-Tech set forth in the complaint and in Gurary's affidavits, which in essence was that Nu-Tech had failed to disclose what it knew of Winehouse's activities. While the papers described Gurary's alleged conversations with Feigenbaum, the articulated grievance against Nu-Tech was its alleged concealment of the short-selling activities, allegedly in order to protect its efforts to buy PCL. Having failed to make the present argument to the district court, plaintiff will not be heard to advance it here. *E.g., Mycak*

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[7] Appellant's Brief ("App. Br.") 29-30. He thus has abandoned any other claims against Nu-Tech, including the contention that the March 14, 1997 press release was misleading.

v. Honeywell, 953 F.2d 798, 803 (2d Cir. 1992); *Schmidt v. Polish People's Republic*, 742 F.2d 67, 70 (2d Cir. 1984). Even if the argument were properly before us, however, it would lack merit.

It is important to recognize that plaintiff's contention with respect to his pivotal conversations with Feigenbaum is that Feigenbaum allegedly stated that Nu-Tech would block the registration of the common. He spoke in the future tense. The statements therefore were ones of intention or of a promissory nature.

In order to state a claim under Rule 10b-5, the plaintiff must "allege material misstatements or omissions indicating an intent to deceive or defraud in connection with the purchase or sale of a security." *Luce v. Edelstein*, 802 F.2d 49, 55 (2d Cir. 1986) (citing *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 47 L. Ed. 2d 668, 96 S. Ct. 1375 (1976)). "The failure to carry out a promise made in connection with a securities transaction is normally a breach of contract. It does not constitute fraud unless, when the promise was made, the defendant secretly intended not to perform or knew than he could not perform." *Mills v. Polar Molecular Corp.*, 12 F.3d 1170, 1176 (2d Cir. 1993).

Here, there is no suggestion in the complaint or in Gurary's affidavit that Feigenbaum did not intend to

do just what he promised at the times he made the statements to which Gurary now points. In consequence, the claim now advanced against Nu-Tech is fundamentally flawed. The complaint was properly dismissed against the corporate defendant.

IV

We come now to the manipulation claim against Winehouse.

THE FINAL PURCHASES

Plaintiff's last two purchases of Nu-Tech shares, which occurred on December 24, 1996 and February 18, 1997, are readily disposed of. He made each just after speaking with Feigenbaum concerning Winehouse's short selling and having been told that Nu-Tech would refuse to register the common into which Winehouse's preferred was convertible, thus preventing him from covering his short position with newly issued common and thereby perhaps deterring further short selling. In consequence, Gurary made each of these purchases in the belief that the prices he paid reflected Winehouse's allegedly manipulative activities.

The gravamen of manipulation is deception of investors into believing that prices at which they

purchase and sell securities are determined by the natural interplay of supply and demand, not rigged by manipulators. *Schreiber v. Burlington Northern, Inc.*, 472 U.S. 1, 12, 86 L. Ed. 2d 1, 105 S. Ct. 2458 (1985). In order to make out a 10b-5 claim, moreover, the plaintiff must allege and prove, among other elements, reliance. *E.g., Acito v. IMCERA Group, Inc.*, 47 F.3d 47, 52 (2d Cir. 1995). In consequence, a private plaintiff in such a case must establish that he or she engaged in a securities trade in ignorance of the fact that the price was affected by the alleged manipulation. *See Ray v. Lehman Brothers Kuhn Loeb, Inc.*, 624 F. Supp. 16, 19 (N.D. Ga. 1984) (plaintiff in § 9(e) manipulation case must show reliance on false appearance of actual or apparent trading). By plaintiff's own admission, this requirement is not satisfied with respect to these two purchases. Judge Stanton therefore correctly dismissed his claim based upon them.

THE INITIAL PURCHASES

Plaintiff's initial purchases of Nu-Tech shares were made on October 31 and November 7, 1996. The alleged manipulation is said to have begun "following [the Winehouse group's] acquisition of a large part of the...Series A Convertible Preferred..." (Cpt ¶ 24)

The district court's dismissal of the claim based on the first purchase was correct. Gurary concedes that the alleged manipulation did not begin until at least November 6, 1996. In order to make out a claim under Rule 10b-5, however, the plaintiff must allege culpable deception "in connection with the purchase or sale of a security..." *E.g., Acito,* 47 F.3d at 52. Quite clearly, any deception inherent in the execution of a manipulative scheme beginning on or after November 6 was not "in connection with" plaintiff's purchase on October 31. *See, e.g., Samuel M. Feinberg Testamentary Trust v. Carter,* 652 F. Supp. 1066, 1080 (S.D.N.Y. 1987).

The matter is not so clear with respect to the second purchase. The complaint alleges that the "initial issue date" of the preferred was November 6, 1996 (Cpt ¶ 21), the day prior to plaintiff's second purchase. In consequence, if one were to assume that the Winehouse group acquired its preferred stock on November 6 and, as the complaint alleges, that the manipulation began "following the acquisition" of the preferred, the November 7 purchase might have been made at the very start of the alleged manipulation. Plaintiff therefore argues that the district court erred in dismissing his claim based on the second purchase because there was an issue of fact as to whether the

alleged manipulation began after the second purchase. But this contention is insufficient to save the complaint.

Viewing the complaint in the light most favorable to plaintiff, he alleges that the scheme to depress the stock began on the day prior to or the very day of the plaintiff's November 7 purchase. The price at which plaintiff purchased on that date, he alleges, was $15.50 - 90 cents per share or 6.2 percent higher than his previous purchase, which concededly antedated the start of the attempt to drive the stock down. But we need not assume that the price plaintiff paid on November 7 was not affected by any short selling, likely as that seems, as the very fact that Gurary was a buyer in a market allegedly depressed by a manipulative scheme is an insurmountable obstacle to his claim based on that purchase.

If Winehouse actually did depress the price of the shares on November 7, plaintiff benefited from that price decline by purchasing at a lower price than he otherwise would have paid. As a general matter, a defrauded buyer is entitled under Rule 10b-5 to recover "only the excess of what he paid over the value of what he got." *Levine v. Seilon, Inc.*, 439 F.2d 328, 334 (2d Cir. 1971) (Friendly, J.); *accord, e.g., Elkind v. Liggett & Myers,*

Inc., 635 F.2d 156, 168 (2d Cir. 1980).[8] Where, as here, a buyer pays less for a security by reason of a defendant's fraud or manipulation, there is no excess of price over value, so the buyer may not recover. Indeed, that is no more than a common sense application of Section 28(a) of the Exchange Act, which provides that "no person permitted to maintain a suit for damages under the provisions of this chapter shall recover...a total amount in excess of his actual damages on account of the act complained of." 15 U.S.C. § 78bb(a). Moreover, it would be anomalous indeed to permit a plaintiff to recover damages where the characteristic that made the conduct complained of unlawful, here the allegedly artificial depression of the price, worked to plaintiff's benefit. *See Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.*, 429 U.S. 477, 50 L. Ed. 2d 701, 97 S. Ct. 690 (1977) (plaintiff claiming injury caused by enhanced

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[8] To the extent that it suggested that a defrauded buyer never may recover on a benefit-of-the-bargain theory, Levine was dictum. *See e.g., McMahan & Co. v. Wherehouse Entertainment, Inc.*, 65 F.3d 1044, 1048 (2d Cir. 1995), cert. denied, 517 U.S. 1190, 134 L. Ed. 2d 781, 116 S. Ct. 1678 (1996); *Commercial Union Assur. Co. v. Milken*, 17 F.3d 608, 614-15 (2d Cir.), cert. denied, 513 U.S. 873, 130 L. Ed. 2d 130, 115 S. Ct. 198 (1994); *Barrows v. Forest Labs., Inc.*, 742 F.2d 54, 59-60 (2d Cir. 1984); *Osofsky v. Zipf*, 645 F.2d 107, 111-12 (2d Cir. 1981). That qualification, however, has no bearing in this case.

competition resulting from merger lacked standing to sue for damages on theory that merger violated antitrust laws because alleged injury not caused by that which allegedly rendered merger unlawful).[9]

Section 10(b) and Rule 10b-5 prohibit fraud only "in connection with" the purchase and sale of securities. Accordingly, only a purchaser or seller may sue thereunder. *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 44 L. Ed. 2d 539, 95 S. Ct. 1917 (1975). Plaintiff nowhere alleges that he sold any shares. To whatever extent that he seeks compensation for the decline in the price of Nu-Tech shares caused by allegedly manipulative short sales in the period following his purchases, the loss was not the product of fraud in connection with the purchase or sale of securities by Gurary and therefore is not recoverable. *See Blue Chip Stamps*, supra, 421 U.S. at 737-38 (decline in value of stock allegedly held in consequence of fraudulent statement not recoverable); *Birnbaum v.*

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[9] Plaintiff alleges also that the price of Nu-Tech common later fell, ultimately to about $2 per share by the time suit was filed in May 1997. It is not entirely clear from the complaint that he seeks to recover for that decline, as his grievance seems to be that he purchased at prices artificially affected by the alleged manipulation. (Cpt P 42) In any case, however, plaintiff may not

(continued next page)

Newport Steel Corp., 193 F.2d 461 (2d Cir.), cert. denied, 343 U.S. 956, 96 L. Ed. 1356, 72 S. Ct. 1051 (1952) (same); *see also First Equity Corp. v. Standard & Poor's Corp.*, 869 F.2d 175, 180 n.2 (2d Cir. 1989) (10b-5 plaintiffs "may recover only for losses that result from decisions to buy or sell, not from decisions to hold or refrain from trading"); *Elkind*, 635 F.2d at 170-71 (defrauded buyer could not recover for subsequent price decline because not "in connection with" the purchase); *Abrahamson v. Fleschner*, 568 F.2d 862, 868 (2d Cir. 1977), cert. denied, 436 U.S. 905, 436 U.S. 913, 56 L. Ed. 2d 414, 98 S. Ct. 2253 (1978) ("requirement of fraud in connection with the purchase or sale of a security is not satisfied by an allegation that plaintiffs were induced fraudulently not to sell their securities").

V

Finally, we turn to Nu-Tech's cross-appeal from the denial of its motion for sanctions pursuant to Section 21D of the Exchange Act, as added and amended by the PSLRA, 15 U.S.C. § 78u-4.

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recover for the decline in the price of his holdings subsequent to his purchases.

Section 21D(c)(1), 15 U.S.C. § 78u-4(c)(1), provides in relevant part that, upon final adjudication of any private action arising under the Exchange Act, "the court shall include in the record specific findings regarding compliance by each party and each attorney representing any party with each requirement of Rule 11(b) of the Federal Rules of Civil Procedure as to any complaint, responsive pleading, or dispositive motion." If the court finds such a violation, "the court shall impose sanctions," although only after giving the party or attorney involved notice and an opportunity to respond. *Id.* § 78(c)(2).

In this case, Nu-Tech moved for the imposition of sanctions pursuant to this statute. Although the judgment implicitly denied Nu-Tech's motion, the district court made no findings regarding compliance with Rule 11(b). As the statute required the district court to make findings, we have no choice but to remand in order to permit it to do so.

VI

The judgment appealed from is affirmed insofar as it granted summary judgment dismissing the

complaint[10] but vacated insofar as it denied Nu-Tech's motion for sanctions. The case is remanded with respect to sanctions for further proceedings consistent with this opinion.

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[10] The district court's dismissal of the state law claims for lack of jurisdiction once it correctly dismissed the federal claims was entirely appropriate. *See* 28 U.S.C. § 1367(c)(3).

Decision And Order Of The District Court Dated January 12, 2000 Finding No Violation Of Rule 11 And Denying Request For Sanctions

UNITED STATES DISTRICT COURT

FOR THE SOUTHERN DISTRICT OF NEW YORK

MORDECHAI GURARY,

Plaintiff,

-against-

ISAAC WINEHOUSE d/b/a WALL & BROAD EQUITIES and NU-TECH BIO-MED, INC,

Defendants.

97 Civ. 3803 (LLS)

January 12, 2000, Decided
January 12, 2000, Filed

LOUIS L. STANTON, U. S. D. J.:

My order dated February 17, 1998, finding no justification for the imposition of sanctions, was part of the joint appendix on appeal and was cited in Nu-Tech's June 15, 1998 brief (p. 34) to the Court of

Appeals. Accordingly, I do not assume that Court was unaware of my order, but rather take that Court's statement (190 F.3d 37 at 47) that I "made no findings regarding compliance with Rule 11(b)" as meaning that it regarded my findings as merely formalistic.

1.

I find as facts, and adopt and incorporate by reference as if fully repeated herein, Part I of the opinion of the Court of Appeals, 190 F.3d 37 at 40-42.

Defendant Nu-Tech argues for sanctions on the grounds succinctly stated in its June 15, 1998 Court of Appeals brief, pp. 34-35: that Gurary's claims "were without foundation in fact and without support in law" because his first two purchases were not in connection with the alleged fraud and his final two purchases were not made in reliance on any omission by Nu-Tech, which has unjustifiably been put to substantial effort and expense in its defense.

2.

On the facts, plaintiff could colorably argue (1) that he relied on the market price as indicating the fair market value of Nu-Tech common stock for his first two purchases, only to see it depressed by illegal market manipulation in violation of section 10(b) of the Securities Exchange Act of 1934, and (2) that in reliance

on Feigenbaum's promise to prevent further manipulation and stabilize the price, plaintiff made two further purchases on which (the promises proving worthless) he suffered even more losses. The continued manipulative short-selling ultimately reduced the stock's price from $15 per share to two dollars or less. Those losses (even if only on paper) resulted directly from his purchases and the co-conspirators' program of short sales, which Nu-Tech knew about and promised to, but did not prevent.

A conceivable extension of existing law might treat such a manipulative program as violating section 10(b)'s prohibition of "any manipulative or deceptive device or contrivance" and Rule 10b-5's prohibition of "any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security." Compare *Paul F. Newton & Co. v. Texas Commerce Bank*, 630 F.2d 1111 (5th Cir. 1980) (buyer, unreimbursed by its principal for stock purchased at artificially-inflated price, sues member of conspiracy which manipulated market, under § 10(b) and Rule 10b-5).

3.

Under *Oliveri v. Thompson*, 803 F.2d 1265 (2nd Cir. 1986) cert. denied 107 S. Ct. 1373 (1987), plaintiff

should not be sanctioned for seeking relief under the securities law which prohibits market manipulation. Although a more scholarly and meticulous practitioner, or one more expert in federal procedure and securities law, might have foreseen that the complaint would be dismissed, it cannot be said "that a competent attorney could not form the requisite responsible belief as to the validity" of plaintiff's claims. *Id.* at 1275. In such matters, "the court is to avoid hindsight and resolve all doubts in favor of the signer" of the pleading, and impose sanctions only when it is "patently clear that a claim has absolutely no chance of success." *Id.* quoting *Eastway Construction Corp. v. City of New York,* 762 F.2d 243, 254 (2nd Cir. 1985).

CONCLUSION

Nu-Tech's motion for sanctions is denied.

So ordered.

DATED: New York, New York
January 12, 2000

S/
LOUIS L. STANTON
U. S. D. J.

Decision of the United States Court of Appeals for the Second Circuit—Gurary II

No. 00-7151

MORDECHAI GURARY

Plaintiff- Appellant,

v.

ISAAC WINEHOUSE and ISAAC WINEHOUSE, doing business as Wall & Broad Equities, Defendants, NU-TECH BIO-MED, INC.

Defendant- Appellee.

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK

ARGUED SEPTEMBER 19, 2000

DECIDED DECEMBER 19, 2000

OPINION OF THE COURT

Before: WALKER, Chief Judge, and MINER and POOLER, Circuit Judges.

MINER, Circuit Judge:

Defendant-appellant Nu-Tech Bio-Med, Inc. ("Nu-Tech") appeals from an order entered in the United States District Court for the Southern District Court of New York (Stanton, J.) denying its motion for sanctions pursuant to the Private Securities Litigation Reform Act of 1995 ("PSLRA") and Federal Rule of Civil Procedure 11 ("Rule 11") against plaintiff-appellee Mordechai Gurary ("Gurary").

Gurary brought suit against Nu-Tech and defendant Isaac Winehouse ("Winehouse") to recover damages for securities fraud pursuant to section 10(b) of the Securities Exchange Act of 1934 (the "Exchange Act"), 15 U.S.C. § 78j, and 17 C.F.R. § 240.10b-5 ("Rule 10b-5") thereunder. The district court granted summary judgment in favor of both defendants and denied their motions for sanctions under Rule 11. We affirmed the summary judgment but remanded for further findings regarding compliance with Rule 11 as mandated by the PSLRA. See *Gurary v. Winehouse*, 190 F.3d 37, 47 (2d Cir. 1999). On remand, the district court concluded that sanctions were not warranted because "[a] conceivable extension of existing law might" render Gurary's claims of securities fraud properly pleaded. *Gurary v.*

Winehouse, 2000 U.S. Dist. LEXIS 188, *2, No. 97-3803, 2000 WL 20706, at *1 (S.D.N.Y. Jan. 12, 2000). For the reasons that follow, we affirm in part, and vacate in part the order of the district court and remand for further proceedings consistent with this opinion.

BACKGROUND

In November[**3] 1996, Nu-Tech raised nearly $14 million by issuing shares of Series A Convertible Preferred Stock (the "preferred"). That stock, while having no voting rights and paying no dividends, was convertible into common stock at the lesser of $17.50 per share or 75 percent of the average closing price of the common stock for the five trading days prior to the date of the holder's notice of conversion. Because the preferred paid no dividends, had no voting rights, and was convertible to common stock at a bargain price, it would almost always be converted. In addition, purchasers of the preferred were likely to profit from conversion no matter what happened to the price of the common stock, provided that the company survived. That is, so long as the price of the common did not fall more than 25 percent after conversion, shareholders of

the preferred would profit by conversion and sale of the common into which the preferred was converted.[1]

This litigation arose out of an alleged scheme by defendant Winehouse in which Winehouse allegedly organized a "cartel" to purchase a percentage of Nu-Tech convertible stock in the names of nominees. He allegedly arranged for a number of securities firms to become market makers in Nu-Tech common stock, and then proceeded to sell the common stock short,[2] allegedly to drive down the price of the common stock. Gurary concedes that this alleged manipulation did not begin before November 6, 1996.

On October 31, 1996, Gurary purchased 1,000 shares of Nu-Tech common stock at $14.60, and then on November 7, 1996, purchased another 5,500 shares at $15.50 per share. After becoming concerned about his

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[1] For example, if the common traded below $23.33 per share immediately prior to conversion, the preferred would be converted at 75 percent of the price (which would be less than $17.50). However, if the common traded above $23.33 immediately prior to conversion, the preferred would be converted at $17.50 (which would be less than 75 percent of the trading price of the common). In either scenario, investors would profit.

[2] A short sale involves the "sale of a security that the seller does not own or has not contracted for at the time of sale, and that the seller must borrow to make delivery." Black's Law Dictionary 1339 (7th ed. 1999).

investment when the stock price began to decline, Gurary spoke with J. Marvin Feigenbaum ("Feigenbaum"), chairman of Nu-Tech, sometime in December 1996. Feigenbaum assured Gurary that he had alerted Winehouse that Nu-Tech would refuse to register the common stock into which the preferred was convertible unless Winehouse and his group stopped shorting the common stock. Feigenbaum predicted that this "threat" would convince Winehouse to stop shorting the stock because a refusal to register the common issued upon conversion would force Winehouse to cover his short position by purchasing Nu-Tech common stock at a possibly higher price in the open market. Based on Feigenbaum's assurances, Gurary purchased another 1,000 shares on December 24, 1996, at a price of $11.75 per share. Gurary claims to have subsequently learned that Winehouse and his associates arranged to "borrow" an unlimited number of shares from market makers for the express purpose of continuing to short the stock using nominee names.

Gurary spoke to Feigenbaum again on February 18, 1997. Feigenbaum told Gurary that he had met that day with Winehouse and others in another attempt to stop the short selling. Feigenbaum explained to Gurary that Nu-Tech had offered to repurchase the group's preferred shares at cost plus ten percent and to allow

the group to keep its existing profits from the short sales if it would cease its activities. Although Winehouse refused the offer, Feigenbaum told Gurary that Nu-Tech would not surrender to Winehouse and would refuse to register the short sellers' shares. Apparently comforted by these assurances, Gurary bought another 8,350 shares of Nu-Tech common at a price of $11.57 that same day.

On March 12, 1997, Feigenbaum and another Nu-Tech board member met with Winehouse and asked that Winehouse and his group accept registration of the common stock into which their preferred was convertible over a period of twelve months rather than insisting that it be registered immediately. Winehouse refused this offer also and said that he would continue to sell short. Nu-Tech common stock dropped approximately $6 per share over the next two days as the Winehouse group continued its short sales. Six days later, Gurary, in a conference call arranged by an intermediary, spoke directly with Winehouse, who allegedly admitted to him that he deliberately had shorted the stock to drive the price down, that he intended to continue, and advised Gurary to sell his shares because the price would drop to "a dollar."

On May 23, 1997, Gurary brought suit against Nu-Tech and Winehouse in the United States District

Court for the Southern District of New York as a result of the alleged manipulation of the Nu-Tech stock. Gurary's complaint principally alleged that defendants Winehouse and Nu-Tech manipulated Nu-Tech's common stock in violation of Section 10(b) of the Exchange Act, 15 U.S.C. § 78j, and Rule 10b-5 thereunder, 17 C.F.R. § 240.10b-5, by making numerous misstatements and omissions of material fact in connection with the purchase and sale of the convertible preferred stock and the shorting of the common stock.[3] .

Both defendants moved to dismiss the complaint pursuant to Federal Rule of Civil Procedure 12(b)(6) for failure to state a claim upon which relief may be granted. In an Affidavit In Opposition to defendants' motion, Gurary's counsel, David Jaroslawicz, requested that he be granted leave to amend the complaint if the district court discovered any pleading deficiency. The district court, observing that Gurary's claims were

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[3] Gurary also brought a claim under section 349 of the New York General Business Law and sought a preliminary injunction to enjoin Nu-Tech from registering the convertible preferred stock pending the outcome of this action. These two pendent state law claims were dismissed for lack of subject matter jurisdiction after summary judgment was granted in favor of the defendants, and we affirmed. *See Gurary*, 190 F.3d at 47 n. 10.

based on four purchases, two purchases on October 31, 1996 and November 7, 1996, and two later purchases on December 24, 1996 and February 18, 1997, granted the motion in favor of Winehouse and Nu-Tech, after converting their 12(b)(6) motion into one for summary judgment.[4] However, the district court did not comment on Gurary's request for leave to amend and therefore implicitly denied it.

Gurary appealed to this Court, and defendants Nu-Tech and Winehouse cross-appealed on the grounds that the district court improperly denied their motions for sanctions made pursuant to the PSLRA. In an opinion dated August 24, 1999, we affirmed in part, and vacated and remanded in part. With respect to Gurary's first purchase on October 31, 1996, we concluded that this purchase failed to state a cognizable claim under Rule 10b-5 because Gurary failed to "allege culpable deception in connection with the purchase or sale of a security" in that the alleged manipulation did not commence until November 6, 1996, and Gurary's first purchase preceded that date. *Gurary*, 190 F.3d at 45

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[4] The district court converted these motions pursuant to Federal Rule of Civil Procedure 12(b)(2) because it considered Gurary's Affidavit In Opposition in rendering its decision. We approved the district court's conversion in the previous appeal. *See Gurary*, 190 F.3d at 43.

(internal quotation marks omitted). We also concluded that Gurary's second purchase failed to state a cognizable claim under Rule 10b-5 because Gurary, at the very most, paid less for the security on November 7, 1996, than he otherwise would have as a result of the defendants' alleged fraud. We noted that a defrauded buyer may only recover "the excess of what he paid over the value of what he got," not the opposite. *Id.* at 46 (internal quotation marks omitted). With respect to Gurary's last two purchases, we concluded that because "there [was] no suggestion in the complaint or in Gurary's affidavit that Feigenbaum did not intend to do just what he promised at the times he made the statements [to Gurary]," Gurary's claim under Rule 10b-5 was "fundamentally flawed" as it failed to allege that Feigenbaum secretly intended not to perform or knew that he could not perform. *Id.* at 44. We also vacated and remanded in part for the district court to make "findings regarding compliance with Rule 11(b) [as mandated by the PSLRA]." *Id.* at 47.

In an order dated January 12, 2000, the district court determined that sanctions were not warranted because Gurary "could colorably argue [based on a conceivable extension of the law:] (1) that he relied on the market price as indicating the fair market value of Nu-Tech common stock for his first two purchases, only

to see it depressed by illegal market manipulation in violation of...the...Exchange Act..., and (2) that in reliance on Feigenbaum's promise to prevent further manipulation and stabilize the price, [Gurary] made two further purchases on which (the promises proving worthless) he suffered even more losses." *Gurary*, 2000 WL 20706, at *1. In addition, the district court noted that "although a more scholarly and meticulous practitioner, or one more expert in federal procedure and securities law, might have foreseen that the complaint would be dismissed, it cannot be said that a competent attorney could not form the requisite responsible belief as to the validity of [Gurary's] claims." *Id.* (internal quotation marks omitted). Nu-Tech now appeals the district court's order.[5] We affirm in part, and vacate and remand in part for further proceedings consistent with this opinion.

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[5] Defendant Winehouse is not a party to the instant appeal.

DISCUSSION

I. THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995 AND RULE 11

In 1995, Congress passed the PSLRA to give "teeth" to Rule 11, "recognizing the need to reduce significantly the filing of meritless securities lawsuits without hindering the ability of victims of fraud to pursue legitimate claims, and [because]...existing Rule 11 has not deterred abusive securities litigation." *Simon DeBartolo Group, L.P. v. Richard E. Jacobs Group. Inc.*, 186 F.3d 157, 166-67 (2d Cir. 1999) (internal quotation marks omitted). The PSLRA, which added section 21D(c), codified at 15 U.S.C. § 78u-4(c)(1), to the Exchange Act, requires that a district court make specific findings as to a party's compliance with Federal Rule of Civil Procedure 11(b) at the conclusion of a case arising under the Exchange Act, *see Simon DeBartolo Group, L.P.*, 186 F.3d at 167 (citing 15 U.S.C. § 78u-4(c)(1)), and also mandates the imposition of sanctions if the court determines that Rule 11 has been violated. *See* 15 U.S.C. § 78u-4(c)(2).

If a court finds a Rule 11 violation, "a rebuttable presumption [arises] that the appropriate sanction for a complaint that substantially fails to comply with Rule 11(b) 'is an award to the opposing party of the

reasonable attorneys' fees and other expenses incurred in the action.'" *Id.* (quoting 15 U.S.C. § 78u-4(c)(3)(A)(ii)). However, if a party against whom sanctions will be imposed successfully meets its burden by providing sufficient "rebuttal evidence" under 15 U.S.C. § 78u-4(c)(3)(B) that such fees and expenses are not appropriate, then courts should "award the sanctions [they] deem[] appropriate pursuant to Rule 11." 15 U.S.C. § 78u-4(c)(3)(C). The PSLRA does not alter the substantive standards for finding a Rule 11 violation but circumscribes "courts' discretion in choosing whether to conduct the Rule 11 inquiry at all and whether and how to sanction a party once a violation is found." *Simon DeBartolo Group, L.P.*, 186 F.3d at 167.

Rule 11(b) provides in relevant part that:

> By presenting to the court (whether by signing, filing, submitting, or later advocating) a pleading, written motion, or other paper, an attorney or unrepresented party is certifying that to the best of the person's knowledge, information, and belief, formed after an inquiry reasonable under the circumstances—
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> ...

> (2) the claims, defenses, and other legal contentions therein are warranted by existing law or by a nonfrivolous argument for the extension, [**14] modification, or reversal of existing law or the establishment of new law;
>
> (3) the allegations and other factual contentions have evidentiary support or, if specifically so identified, are likely to have evidentiary support after a reasonable opportunity for further investigation or discovery[.]

Fed. R. Civ. P. 11(b). The 1993 Advisory Committee Notes explain that Rule 11(b)(2) "establishes an objective standard, intended to eliminate any 'empty-head pure-heart' justification for patently frivolous arguments." Also, "the extent to which a litigant has researched the issues and found some support for its theories even in minority opinions, in law review articles, or through consultation with other attorneys should certainly be taken into account in determining whether paragraph [(b)](2) has been violated. Although arguments for a change of law are not required to be specifically so identified, a contention that is so identified should be viewed with greater tolerance under the rule." *Id.* While monetary sanctions may be imposed in some circumstances under Rule 11, see Fed. R. Civ. P. 11(c)(2), they "may not be awarded against a

represented party for a violation of subdivision (b)(2)," Fed. R. Civ. P. 11(c)(2)(A), because "responsibility for such violations is more properly placed solely on the party's attorneys." Fed. R. Civ. P. 11 (advisory committee notes to 1993 amendments); *see also Simon DeBartolo Group, L.P.*, 186 F.3d at 166.

II. STANDARD OF REVIEW

We review a district court's determination with respect to sanctions under the PSLRA and Rule 11 for abuse of discretion. *See Simon DeBartolo Group, L.P.*, 186 F.3d at 167 (citing *Cooter & Gell v. Hartmarx Corp.*, 496 U.S. 384, 405, 110 L. Ed. 2d 359, 110 S. Ct. 2447 (1990)). Rule 11 is violated when it is "clear under existing precedents that there is no chance of success and no reasonable argument to extend, modify or reverse the law as it stands." *Id.* (quoting *Mareno v. Rowe*, 910 F.2d 1043, 1047 (2d Cir. 1990)) (internal quotation marks omitted). That is, material errors of law constitute "per se abuses of discretion." *Id.*; *see also Cooter & Gell*, 496 U.S. at 405 (concluding that an erroneous view of the law would constitute abuse of a court's discretion); *Sussman v. Bank of Israel*, 56 F.3d 450, 456 (2d Cir. 1995) (same); *see also Pierce v. F.R. Tripler & Co.*, 955 F.2d 820, 831 (2d Cir. 1992) (finding an abuse of discretion where the district court awarded sanctions against a party

who has a good faith basis to pursue legal argument supported by one state court decision in the absence of contrary controlling authority).

III. IMPOSITION OF SANCTIONS

Citing *Eastway Construction Corp. v. City of New York*, appellant Nu-Tech asserts generally that the district court abused its discretion in denying sanctions against defendant-appellee Gurary because his claims against Nu-Tech involving all four purchases "failed to satisfy fundamental and threshold requirements for a Rule 10b-5 claim" and that Gurary has "failed...to suggest any reason that he could have achieved 'success under existing precedents,' and...has failed to advance any 'reasonable argument...to extend, modify or reverse the law as it stands.'" 762 F.2d 243, 254 (2d Cir. 1994). We agree with respect to Gurary's first two purchases, on October 31, 1996 and November 7, 1996, respectively, but disagree with respect to Gurary's December 24, 1996 and February 18, 1997 purchases.[6]

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[6] Gurary argues that the issue on appeal here is moot because we "overlooked" the fact the district court had already rendered such findings, and there was no need to remand. We disagree. First, we concluded that remand was required because the "district court made no findings regarding compliance with Rule 11(b)." *Gurary*, 190 F.3d at 47. Second, the only "findings"

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A. THE INITIAL PURCHASES: OCTOBER 31, 1996 AND NOVEMBER 7, 1996

The district court on remand concluded that sanctions were inappropriate because Gurary "could colorably argue...that he relied on the market price as indicating the fair market value of Nu-Tech common stock for his first two purchases, only to see it depressed by illegal market manipulation in violation of section 10(b) of the Securities Exchange Act of 1934." Gurary, 2000 WL 20706, at *1. That conclusion ignores both the plain language of the Exchange Act and well-settled case law prohibiting recovery on any claims arising out of Gurary's first two purchases, and we therefore conclude that the district court abused its discretion by not imposing sanctions in connection with these claims.

Section 10(b) of the Exchange Act and Rule 10b-5 thereunder provide that a plaintiff must allege material

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made by the district court at the time it granted summary judgment included a conclusory statement that "the claims and arguments made in the complaint...were 'warranted by existing law or by a nonfrivolous argument for the extension, modification, or reversal of existing law or the establishment of new law'...and were not 'presented for any improper purpose.'" Accordingly, we have yet to review specific findings of the district court as mandated by the PSLRA.

misstatements or omissions indicating an intent to deceive or defraud "in connection with the purchase or sale of a security." 17 C.F.R. § 240.10b-5 (emphasis added); *see also Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 737-38, 44 L. Ed. 2d 539, 95 S. Ct. 1917 (1975). Gurary's complaint alleges a violation of 10b-5 with respect to his first purchase on October 31, 1996, although Gurary concedes that the alleged manipulation of Nu-Tech's stock did not begin until at least November 6, 1996. Based on the plain language of section 10(b) and well-settled case law, Gurary's October 31, 1996 purchase could not under any circumstances give rise to a Rule 10b-5 cause of action because that purchase occurred before any alleged deception began, and therefore could not be in connection with the purchase or sale of a security. *See, e.g., Blue Chip Stamps*, 421 U.S. at 737-38; *see also* 15 U.S.C. § 10(b); 17 C.F.R. § 240.10b-5. Accordingly, Gurary's claim based on his October 31, 1996 security purchase was not warranted by existing law.

Nor could Gurary's claim be supported by any colorable argument for a change in existing law. The "in connection with the purchase or sale of a security" requirement of section 10(b) and Rule 10b-5 would prohibit a court from adopting a rule that would support Gurary's claim. This is not a case, in other

words, in which a litigant seeks only to swim upstream against the current of *stare decisis*, in which case a particularly trenchant argument for rejecting existing precedent might be availing. Rather, the statute and regulation applicable here are incapable of judicial revision and thus precluded the district court from adopting any theory that would impose liability for a purchase entirely unconnected with alleged fraud.

Similarly, Gurary's claim based on his second purchase was not sustainable under any existing theory of law. Under well-settled principles, a buyer defrauded in violation of the securities laws may "recover only the excess of what he paid over the value of what he got, not...the difference between the value of what he got and what it was represented he would be getting." *McMahan & Co. v. Wherehouse Entertainment, Inc.*, 65 F.3d 1044, 1049 (2d Cir. 1995) (quoting *Levine v. Seilon, Inc.*, 439 F.2d 328, 334 (2d Cir. 1971)) (internal quotation marks omitted). That is, if the price of the common stock had been depressed because of the alleged manipulation, then a purchaser of a security actually benefits from that price decline by purchasing the stock at a lower price than he otherwise would have paid. Gurary alleged that the manipulation began on or about November 6, 1996, one day before his second purchase. As a result, if we infer that the

short selling scheme actually depressed the price of the common stock on November 7, 1996, then Gurary would have benefited from that manipulation by purchasing at a lower price than he otherwise would have paid. Consequently, because Gurary paid less for the security as a result of the defendants' alleged fraud or manipulation, there is no excess of price over value, and Gurary may not recover under Rule 10b-5. *See, e.g., Levine,* 439 F.2d at 334. Accordingly, Gurary's 10b-5 claim against Nu-Tech with respect to this second purchase was not warranted under existing law because it directly contradicts well-settled principles of Exchange Act jurisprudence.

Gurary made no argument before the district court for modification or extension of the law that would justify imposition of liability for his second purchase, and he also expressly refused to make any such argument on appeal. Although litigants are not required to articulate their arguments for legal change, see Fed. R. Civ. P. 11 (advisory committee notes to 1993 amendments) ("Arguments for a change of law are not required to be specifically so identified, [but] a contention that is so identified should be viewed with greater tolerance under the rule."), they fail to do so at the risk that a court may be unable to supply one sua sponte. Here we can conceive of no nonfrivolous

argument for a change in the law to save Gurary's claim based on the second purchase, and the district court was unable to make such an argument in its decision refusing to award sanctions. Accordingly, we must conclude that no nonfrivolous argument for the modification or extension of law can be made to save Gurary's claim, and that sanctions therefore were mandatory.

In accordance with the foregoing, Gurary's claim arising out of his first two purchases violated Rule 11(b)(2), and therefore sanctions are mandated pursuant to the PSLRA.[7] Nevertheless, Gurary asserts that *Simon DeBartolo Group, L.P.*, stands for the proposition "that where a complaint was dismissed but its merits were nevertheless arguable, sanctions under the PSLRA are not warranted." However, Gurary misconstrues our holding in *Simon DeBartolo Group, L.P.* In that case, we reversed the district court's determination that plaintiff DeBartolo's 10b-5 cause of

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[7] Gurary asserts that "if sanctions were for any reason to be imposed in this case, they should be diminished" because we have concluded generally that when some of a plaintiff's claims are deemed frivolous in violation of Rule 11 but others are not, the amount of sanctions should be reduced accordingly. *See, e.g., Simon Debartolo Group, L.P.*, 186 F.3d at 177-78. However, that issue is not

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action was frivolous "because there were non-frivolous allegations and arguments supporting each element of [DeBartolo's] Rule 10b-5 cause of action and [because] DeBartolo arguably had standing [based on existing case law] to assert [its] claim." 186 F.3d at 174.

As a consequence, we are constrained to conclude that the denial of sanctions pertaining to the claims arising out of Gurary's first two purchases constituted a material error of law. *See Simon DeBartolo Group, L.P.*, 186 F.3d at 167. We therefore remand for the district court to determine appropriate sanctions pursuant to 15 U.S.C. § 78u-4(c)(3)(A)-(C).[8]

B. THE SECOND TWO PURCHASES: DECEMBER 24, 1996 AND FEBRUARY 18, 1997

Nu-Tech urges that sanctions also must be imposed with respect to the claims based on the second two purchases because these claims too lack factual or

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before us and we do not address that issue in view of our decision to remand.

[8] We note here that because we find that these two claims violate Rule 11(b)(2), sanctions should only be imposed against Gurary's counsel and not Gurary himself. See Fed. R. Civ. P. 11(c)(2)(A) (prohibiting an award of monetary sanctions "against a represented party for a violation of subdivision 11(b)(2)").

legal support. In support of its argument, Nu-Tech points to our previous findings that "any allegation of reliance was 'fundamentally flawed'...because 'there is no suggestion in the complaint or Gurary's affidavit that Feigenbaum did not intend to do just what he promised.'" Gurary argues in opposition that his intent to plead scienter "could fairly have been gleaned from the gist of [his] complaint" and that he simply failed to satisfy a "pleading technicality," making sanctions unwarranted. Gurary's contention that he merely failed to comply with a "technicality" is something of an exaggeration. Gurary did not press his current theory in his complaint or affidavits filed before the district court. It was not until he appealed the dismissal that he began to argue that he relied on Feigenbaum's assurances in making the final two purchases. *See Gurary*, 190 F.3d at 44. In any event, the district court determined that sanctions were inappropriate with respect to these later two purchases because "in reliance on Feigenbaum's promise to prevent further manipulation and stabilize the price, [Gurary] made two further purchases on which (the promises proving worthless) he suffered even more losses." Gurary, 2000 WL 20706, at *1. While we disagree with the district court's reasoning and Gurary's position on appeal, we

agree that sanctions are not appropriate with respect to Gurary's second two purchases.

It is well-settled that "the failure to carry out a promise made in connection with a securities transaction is normally a breach of contract" and does not justify a Rule 10b-5 action. *Mills v. Polar Molecular Corp.*, 12 F.3d 1170, 1176 (2d Cir. 1993). Such a promise does not constitute fraud pursuant to 10b-5 "unless, when the promise was made, the defendant secretly intended not to perform or knew that he could not perform." *Id.* We recognize that "there [was] no suggestion in the complaint or in Gurary's affidavit that Feigenbaum did not intend to do just what he promised at the times he made the [promissory] statements," *Gurary*, 190 F.3d at 44, and that Gurary therefore failed to adequately plead the requisite reliance on false statements made by Feigenbaum with scienter. *See, e.g., Ganino v. Citizens Util. Co.*, 228 F.3d 154, 161 (2d Cir. 2000) ("Plaintiff must plead that the defendant, in connection with the purchase or sale of securities, made a materially false statement or omitted a material fact, with scienter, and that plaintiff's reliance on the defendant's action caused [his] injury."); *see also* 17 C.F.R. § 240.10b-5. However, it does not necessarily follow that such a deficient pleading mandates a finding that Rule 11 has been violated.

David Jaroslawicz, Gurary's counsel, in an affidavit in opposition to Nu-Tech's motion to dismiss, requested leave to amend the complaint to comply with securities laws' pleading requirements in the event the district court decided to dismiss his claim for any reason. However, the district court never addressed Gurary's request to amend his complaint (nor did this Court on the previous appeal) and therefore implicitly denied it.

A district court has broad discretion in determining whether to grant leave to amend, and we review such determinations for abuse of discretion. *See, e.g., Commander Oil Corp. v. Barlo Equip. Corp.*, 215 F.3d 321, 333 (2d Cir. 2000) ("Leave to amend shall be freely given, and this court reviews the district court's actions for abuse of discretion."); *see also Monahan v. New York City Dep't of Corrections*, 214 F.3d 275, 283 (2d Cir. 2000) ("We review the district court's decision to grant a party leave to amend for abuse of discretion."). While the district court did not abuse its discretion by implicitly denying Gurary leave to amend his complaint to cure the deficiency, *see, e.g., Confederate Mem'l Assoc. v. Hines*, 301 U.S. App. D.C. 395, 995 F.2d 295, 299 (D.C. Cir. 1993) (holding that the district court did not abuse its discretion by denying leave to amend where plaintiffs made only a "bare request"), it would

also not have been an abuse of that court's discretion to allow the requested leave to amend. *See McLaughlin v. Anderson*, 962 F.2d 187, 195 (2d Cir. 1992) (stating that "lack of a formal motion is not [a] sufficient ground for a district court's dismissal without leave to amend, so long as the plaintiff has made its willingness to amend clear"); *see also Oliver Schs., Inc. v. Foley*, 930 F.2d 248, 252-53 (2d Cir. 1991) (noting that leave to amend should be granted even without an explicit motion where the adverse party had knowledge of desire to amend). Because we do not believe that the PSLRA was designed to mandate sanctions in all cases for a complaint that, if properly pleaded, could state a cognizable claim under the securities laws, we examine Gurary's case to determine whether an amendment could have stated such a claim.

Had Gurary been afforded the opportunity to amend his complaint to allege Feigenbaum's misrepresentations with proper specificity, as he apparently sought to do, Gurary could have asserted a cognizable claim under Rule 10b-5 with respect to his second two purchases. *See, e.g., Polar Molecular Corp.*, 12 F.3d at 1176. Gurary certainly had some basis for believing that evidence was available to demonstrate that Feigenbaum was making, with scienter, false representations regarding future events viz., that he

was able to, and would, head off the short sales being made by the Winehouse group. It simply cannot be said at such an early stage in the proceedings that Gurary's claims based on the second two purchases would have completely lacked evidentiary support because Gurary was never afforded the opportunity to pursue discovery. Federal Rule of Civil Procedure 11(b)(3) specifically provides that the rule is not violated if the "allegations and other factual contentions have evidentiary support or, if specifically so identified, are likely to have evidentiary support after a reasonable opportunity for further investigation or discovery." Fed. R. Civ. P. 11(b)(3) (emphasis added). Accordingly, Gurary, after amending his complaint and through further investigation and discovery, could have developed some factual support that Feigenbaum "secretly intended not to perform or knew that he could not perform" the promises he made to Gurary. *See, e.g., Polar Molecular Corp.*, 12 F.3d at 1176.

Although Gurary's claim may not have survived summary judgment even with further discovery because of the inherent difficulty in establishing the subjective intent of Feigenbaum, we conclude that Gurary's failure to sufficiently plead the necessary elements of a cognizable 10b-5 claim does not warrant sanctions under the PSLRA in this instance because the

district court could have, within its broad discretion, afforded Gurary leave to amend his complaint, which would have resulted in a cognizable 10b-5 claim.

CONCLUSION

In accordance with the foregoing, the order of the district is affirmed on other grounds in part, and vacated and remanded in part for further determinations consistent with this opinion.

Order Denying Rehearing and Denying Rehearing En Banc

At a stated term of the United States Court of Appeals for the Second Circuit, held at the United States Courthouse, Foley Square, in the City of New York, on the ____ [sic] day of February two thousand one.

MORDECHAI GURARY,

Plaintiff-Appellee,

v.

Docket No. 00-7151

ISSAC WINEHOUSE and ISSAC WINEHOUSE, doing business as Wall & Broad Equities,

Defendants,

NU-TECH BIO-MED, INC.,

Defendant-Appellant

A petition for panel rehearing and a petition for rehearing en banc having been filed herein by the appellee Mordechai Gurary.

Upon consideration by the panel that decided the appeal, it is Ordered that said petition for rehearing is DENIED.

It is further noted that the petition for rehearing en banc has been transmitted to the judges for the court in regular active service and to any other judge that

heard the appeal and that no such judge has requested that a vote be taken thereon.

FOR THE COURT
ROSEANN B. MACKECHNIE, Clerk
By: S/_____
Beth J. Meador,
Administrative Attorney

[stamp:]

United States Court of Appeals
Filed
February 28, 2001
Roseann B. Mackechnie, Clerk
Second Circuit

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

----------X

MORDECHAI GURARY, 97 Civ. 3803

Plaintiff,

COMPLAINT

-against- **Jury Trial Demanded**

ISAAC WINEHOUSE, ISAAC WINEHOUSE d/b/a WALL & BROAD EQUITIES and NU-TECH BIO-MED, INC.,

Defendants.

----------X

Plaintiff, by his attorneys, **JAROSLAWICZ & JAROS**, complaining of the defendants, alleges as follows:

THE PARTIES

1. At all times hereinafter mentioned, plaintiff, Mordechai Gurary, is a citizen of the State of New York.

2. At all times hereinafter mentioned, the defendant, Isaac Winehouse ("Winehouse"), is believed to be a resident of the State of New York and citizen of Israel.

3. At all times hereinafter mentioned, the defendant Winehouse is doing business under the name of Wall & Broad Equities, among entities that he controls.

4. At all times hereinafter mentioned, the defendant, Nu-Tech Bio-Med, Inc. ("Nu-Tech"), is a Delaware corporation with its principal place of business in the State of New York.

JURISDICTION & VENUE

5. This Court has jurisdiction over this matter pursuant to the Securities Exchange Act of 1934, 15 U.S.C. 78aa, since the claims herein arose under Section 10(b) of the Securities Exchange Act of 1934.

6. Venue is proper in this District pursuant to Section 27 of the Securities Exchange Act of 1934, 15 U.S.C. 78aa since the corporation is located here and most of the acts complained of occurred within this District.

7. Many of the acts complained of herein, including the dissemination of information, the agreement entered into with respect to the December 1996 placement, commonly known as a Regulation D Placement, for a total purchase price of $14 million, and the manipulation of the stock price of Nu-Tech, took place within this District.

8. In connection with the acts alleged in this complaint, the defendant Winehouse and others included in his cartel, directly and indirectly, used the means and instrumentalities of interstate commerce, including the mails, telephone communications, and the facilities of national security exchanges, to perpetrate their fraud.

THE UNDERLYING FACTS

9. That Nu-Tech was originally organized in approximately 1981.

10. That Nu-Tech is traded on the NASDAQ stock market under the symbol NTBM.

11. That the price of Nu-Tech stock hit a high of approximately $16 per share in November 1996.

12. That the price of Nu-Tech stock was relatively stable between October and November 1996.

13. That the plaintiff made at least the following purchases of Nu-Tech stock:

AMOUNT OF SHARES	PRICE PER SHARE	DATE OF PURCHASE
1,000	$14.60	1/31/96
5,500	15 1/2	11/7/96
1,000	11 3/4	12/24/96
8,350	11 19/16	2/18/97

14. That by early March 1997, due to the prior actions and continuing improper manipulations of the defendant Winehouse and others, Nu-Tech stock dropped precipitously so that it is trading in the area of $2 per share.

15. That the defendant Winehouse was the organizer and/or one of the key people of a cartel organized to engage in transactions in the purchase of the Regulation D Placement and the sale of Nu-Tech stock and perhaps other securities.

16. That this group arranged to participate in a purchase, under circumstances not totally known to the plaintiff, of a percentage of the 14 million dollars' worth of Nu-Tech stock, to wit, some fourteen thousand shares of Series A Convertible Preferred Stock for a total aggregate price of $14 Million, and upon information and belief this took place in approximately November 1996.

17. That during this time period, the defendant Winehouse arranged for certain market makers to become market makers in Nu-Tech stock; these market makers included Alexander Securities and Sun Coast Securities, and perhaps others; that in addition to this, it is believed that at this time there are approximately sixteen market makers in the stock of Nu-Tech, to wit the firms of Wien Securities; Knight Securities; Kensington Capital; Paragon Capital Corp.; Southwest Securities; Spencer Edwards; Hill Thompson Magid; Meyer & Schweitzer; Sharp Capital; Duke & Co.; Nash Weiss & Co.; D. Weckstein & Co.; Starr Securities; Wall Street Equities; Herzog Heine Geduld; and Grunthal.

18. Upon information and belief, the defendant Winehouse arranged for, or was instrumental in having one or more of these market makers become a market maker in Nu-Tech in order for them to be used in his scheme of manipulating the price of and permitting him to engage in short-selling Nu-Tech stock.

19. That the Series A Convertible Preferred Stock obtained by Winehouse through nominees and other members of his cartel whose names are not yet known to plaintiff, is convertible into shares of common stock of Nu-Tech at either (a) $17.50 per share; or (b)

seventy-five (75%) percent of the average closing price of the company's common stock as represented by NASDAQ for the five trading days prior to the date of the holder's note of conversion.

20. That the Series A Convertible Preferred Stock is converted into the company's common stock at the option of the holder commencing on the forty-fifth day after the issue date with one-third of the shares being permitted to be converted into common stock on the forty-fifth, seventy-fifth and one hundred-fifth days after the issue date.

21. That the initial issue date was November 6, 1996 and the first day upon which the holders could initially obtain a conversation of Series A Convertible Preferred Stock was December 20, 1996.

22. That commencing on the two hundred-seventieth day following the completion of the private placing, Nu-Tech had the right, on thirty days prior notice, to compel Series A Preferred Stock to be converted into common stock at the then applicable conversion price.

AS AND FOR A FIRST CLAIM FOR RELIEF AS AGAINST THE DEFENDANTS ISAAC

WINEHOUSE AND ISAAC WINEHOUSE D/B/A WALL & BROAD EQUITIES

23. That Winehouse and other members of his cartel reached a secret arrangement whereby a large part of the $14 million purchase of Series A Preferred Convertible Stock was purchased in the name of other nominees who were not really the owners of the stock, and who later engaged in short-selling Nu-Tech stock in the name of other nominees.

24. That following the acquisition of a large part of the fourteen thousand shares of Series A Convertible Preferred Stock, Winehouse and his group manipulated the price of Nu-Tech stock.

25. It is also improper under the regulations of the Securities & Exchange Commission ("SEC") and the stock exchange for someone who purchases a convertible preferred stock to short stock and to do so under different names in order to conceal the identity of the person shorting and the fact that the same people who have a beneficial right to purchase or convert preferred stock into common stock are engaged in shorting the stock.

26. That the defendant Winehouse and other members of his cartel, whose names have not yet been

established, engaged in a series of efforts to conceal that they were shorting Nu-Tech

stock, using various nominee accounts which they had set up, with the ultimate beneficiaries being Winehouse, Wall & Broad Equities and members of Winehouse's cartel.

27. That the activities of Winehouse and the members of his group became known to Nu-Tech and its Chairman, one Marvin Feigenbaum.

28. That in or about December 1996, Mr. Feigenbaum, the Chairman of Nu-Tech called Winehouse and Winehouse's counsel to advise that if the Winehouse group did not stop shorting Nu-Tech stock, he would not permit the registration of the convertible shares to become effective.

29. Upon information and belief, a meeting was held on February 18, 1997 at Nu-Tech's offices at 500 Fifth Avenue in New York City, which meeting was attended by Winehouse, Abe Silver, Sam Popack, Mr. Hagar, Stuart Kahan, Marvin Feigenbaum and others. At which time, Feigenbaum, on behalf of the company, requested Winehouse and his cartel and group to stop shorting Nu-Tech stock and offered that within six months Nu-Tech would repurchase their convertible preferred stock for the $14 million which had been

originally paid plus ten percent interest on the $14 million and that the short sellers would be permitted to keep their profits.

30. That to the knowledge of plaintiff, no agreement was reached at that meeting with Winehouse and his cartel demanding still more benefits from the company.

31. That the fact that this meeting took place as well as the offer made by the company to Winehouse was concealed from the investing public.

32. Upon information and belief, on or about March 12, 1997 a second meeting took place at the offices of Fagenson & Co., 19 Rector Street in New York City, which meeting was attended by Robert Fagenson, a member of the Board of Directors of Nu-Tech; Silver; Popack; Winehouse and others; and Marvin Feigenbaum, Chairman of Nu-Tech.

33. Upon information and belief, at that meeting Nu-Tech sought to have the defendant Winehouse and his group agree that their stock would be registered over a twelve-month period.

34. Upon information and belief, that Winehouse indicated this was not satisfactory and stated he would continue his short-selling activities.

35. That the following day Nu-Tech stock dropped approximately $3 and the day thereafter an additional $3. Upon information and belief, this was caused in large part by short selling by Winehouse and his group.

36. That on or about March 14, 1997, Nu-Tech issued a press release which was flagrantly misleading, indicating that it believed the decline in the price of Nu-Tech stock could be attributable to "possible sales by shareholders" (Exhibit A).

37. That Nu-Tech concealed the various meetings and what had transpired, and their knowledge as to the Winehouse group shorting Nu-Tech stock.

38. In the interim, Winehouse, through his counsel Heller, Horowitz & Feit, P.C., was negotiating with counsel for Nu-Tech, all of which information was not made publicly available.

39. That the activities of Winehouse and his cartel, and the various names Winehouse and his group have been doing business under, to purchase the convertible stock and then shorting the Nu-Tech stock and manipulating its price, constituted a fraud upon the market.

40. In addition, the defendant Winehouse and the other members of his cartel engaged in a planned scheme and course of conduct pursuant to which they knowingly sought to manipulate the price of Nu-Tech stock by improperly shorting the stock under different names to conceal their true identities.

41. That the defendants made numerous misstatements of material fact and omitted to state material facts necessary in order to make statements not misleading in light of the circumstances under which they were made.

42. As a result of these defendants' fraudulent conduct, plaintiff were caused to purchase Nu-Tech's stock at artificial prices and to incur substantial losses.

43. That the defendants' conduct constituted a deliberate violation of §10b of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder.

44. By reason of the foregoing, the defendants are jointly and severally liable to the plaintiff.

45. By reason of the foregoing, plaintiff is entitled to recover all of his damages from these defendants.

AS AND FOR A SECOND CLAIM FOR RELIEFAS AGAINST THE DEFENDANT NU-TECH BIO-MED, INC.

46. Plaintiff hereby repeats, reiterates and realleges each and every allegation contained in paragraphs of this complaint numbered "1" through "45" inclusive, with the same force and effect as if more fully set forth at length herein.

47. That the defendant Nu-Tech failed to reveal the sale to Winehouse and his group through the use of nominees; that there were meetings going on between Winehouse and his group and Nu-Tech; that Nu-Tech was aware of the short-selling by Winehouse and his group; that Nu-Tech would refuse to register certain stocks due to the short-selling activities of Winehouse and his group; that, in fact, when Nu-Tech finally did issue a public statement in response to an inquiry from the NASDAQ, it issued a deliberately misleading statement as to the reason for the stock's decline (Exhibit A), omitting to state the real reason and that negotiations were taking place between Nu-Tech and the Winehouse group.

48. That during this same period, Nu-Tech was engaging in an attempt to acquire certain debt securities of Physicians Clinical Laboratory, Inc.

("PCL"); that the PCL deal was subject to the approval of the United States Bankruptcy Court for the Central District of California, case number SV 96-23185-GM; that in order to conceal from the Bankruptcy Court, the market and plaintiff as to what was taking place and in an attempt to induce Winehouse and other short sellers not to object to the plan in the Bankruptcy Court, Nu-Tech concealed this critical information from the public and from the plaintiff.

49. That Nu-Tech's conduct constituted fraud with respect to concealing material information and providing misinformation pursuant to 15 U.S.C. 78(j) and Rule 10 b-5 promulgated thereunder.

50. By reason of the foregoing, plaintiff has been damaged as aforesaid.

51. By reason of the foregoing, the defendants are jointly and severally liable to the plaintiff.

52. By reason of the foregoing, plaintiff is entitled to recover all of his damages from this defendant.

AS AND FOR A THIRD CLAIM FOR RELIEF AS AGAINST ALL THE DEFENDANTS

53. Plaintiff hereby repeats, reiterates and realleges each and every allegation contained in paragraphs of this complaint numbered "1" through "45" and "47" through "52" inclusive, with the same force and effect as if more fully set forth at length herein.

54. That the conduct of Winehouse and his group and Nu-Tech constituted a fraudulent business practice in direct violation of §349 of the General Business Law of the State of New York.

55. By reason of the foregoing, plaintiff has been damaged as aforesaid.

56. By reason of the foregoing, the defendants are jointly and severally liable to the plaintiff.

57. By reason of the foregoing, plaintiff is entitled to recover all of his damages from the defendants, including treble damages, punitive damages and attorneys' fees.

AS AND FOR A FOURTH CLAIM FOR RELIEF AS AGAINST THE DEFENDANT NU-TECH BIO-MED, INC.

58. Plaintiff hereby repeats, reiterates and realleges each and every allegation contained in paragraphs of this complaint numbered "1" through "45", "47" through "52" and "54" through "57" inclusive, with the same force and effect as if more fully set forth at length herein.

59. That the plaintiff does not have a complete or adequate remedy at law.

60. That Nu-Tech should be enjoined from registering the $14 million Series A Convertible Preferred Stock pending the hearing and determination of this action.

WHEREFORE, plaintiff demands judgment as against the defendants, both jointly and severally, as follows:

(a) Awarding plaintiff all compensatory damages such as may be permitted, together with interest;

(b) Enjoining Nu-Tech from registering the $14 million Series A Convertible Preferred Stock pending the hearing and determination of this action;

(c) Awarding plaintiff costs and expenses incurred, including reasonable attorneys' fees, expert fees, as well as treble damages and punitive damages; and

(d) Awarding plaintiff such other and further relief as to this Court may seem just and proper.

Dated: New York, New York
May 15, 1997

JAROSLAWICZ & JAROS, ESQS.
Attorneys for Plaintiff(s)

By: S/_____
David Jaroslawicz (DJ 6931)

Office and Post Office Address
150 William Street
New York, New York 10038
(212) 227-2780

Affidavit Of Plaintiff Gurary Dated August 20, 1997 Submitted In Opposition To Defendants' Rule 12(b)(6) Motion

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

----------X

MORDECHAI GURARY, 97 Civ. 3803

Plaintiff,

-against-

AFFIDAVIT IN OPPOSITION

ISAAC WINEHOUSE, ISAAC WINEHOUSE d/b/a WALL & BROAD EQUITIES and NU-TECH BIO-MED, INC.,

Defendants.

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STATE OF NEW YORK }
} ss.:
COUNTY OF NEW YORK }

MORDECHAI GURARY, being duly sworn, deposes and says:

I am currently the holder of 36,400 shares in Nu-Tech Bio Med, Inc. ("Nu-Tech") and am making this

affidavit with respect to the defendants" motions to dismiss.

The facts of this case are that I, and numerous other innocent investors, invested substantial funds in Nu-Tech when the stock was trading between approximately eleven dollars a share and fifteen dollars a share.

That in about November, 1996, the company, in an effort to raise money, entered into an arrangement, which I am advised is known as a Regulation D Placement, where they raised fourteen million dollars from certain investors. These investors were entitled to a Series A Convertible Preferred Stock. These investors would be entitled to convert their shares into Nu-Tech common stock at either $17.50 per share or seventy-five (75%) percent of the average closing price of the company's common stock as reported by NASDAQ for the five trading days prior to the date the holder's note of conversion.

That this Series A Convertible Preferred Stock was convertible at the holder's opinion, commencing forty-five days after the issue date, with one-third of the shares being permitted to be converted into common stock on day forty-five, one-third on day seventy-five and on-third on day one hundred-five after issue date.

That the initial issue date for the Series A Convertible Preferred Stock was November 6, 1996 with the anticipation that the first day upon which the holders could convert the Series A Convertible Preferred Stock would be December 20, 1996.

That Isaac Winehouse, whom I have met with and spoken to, has been involved, through an entity known as Wall & Broad Equities, and through various nominees, in buying and selling different securities.

As can be seen from Exhibit B to the motion papers by Nu-Tech (pp. 28-29), as well as Exhibit A to this affidavit, Mr. Winehouse's name appears nowhere in the prospectus as one of the owners of any of the Series A Convertible Preferred Stock.

Nevertheless, Mr. Winehouse, acting on behalf of unknown nominees, was the moving force behind the scheme which had been entered into by certain purchasers of the Series A Convertible Preferred Stock to, in essence, lock in a profit by shorting Nu-Tech stock, knowing that the lower the price of Nu-Tech stock, the greater would be their profit because the cheaper they would be able to buy it at seventy five percent of whatever the average price was five trading days prior to their conversion.

That in an unusual move, when it became obvious to the company that certain Series A Convertible Preferred Stock holders were shorting the stock, the company, after filing with the SEC, withdrew its proposed registration of that stock in late December 1996.

When Nu-Tech stock started to decline, I, as other shareholders of Nu-Tech, became concerned. I personally spoke to Marvin Feigenbaum, the president of Nu-Tech, in or about December, 1996—I do not recall the exact date—and he advised me that he had spoken to Isaac Winehouse, the defendant in this case, as well as to Mr. Winehouse's counsel, Heller, Horowitz & Feit, P.C. and alerted them that if the Winehouse group did not stop shorting Nu-Tech stock, he would withdraw the registration of those shares so that the group, rather than being assured of a locked-in profit, would have to buy the stock in the open market at possibly higher prices and that this would convince them not to continue shorting the stock.

I continued to buy Nu-Tech stock, buying one thousand shares on December 24, 1996 at 11-3/4.

Thereafter, the Winehouse group continued to short the stock. I investigated into the matter and was advised that in order to short the stock, Winehouse had arranged for certain market makers, small brokerage

firms, who were friendly to him, to become so-called market makers in Nu-Tech, thus permitting the defendants to short the stock, through those brokerage firms, without having the stock available. This way the Winehouse group could short an unlimited amount of stock.

I am advised that the brokerage firms involved in becoming market makers and assisting Mr. Winehouse included Alexander Securities, Sharp, Grunthal, and Sun Coast Securities.

I was advised by a broker in Canada who works for Gundy & Co. in Toronto, Canada, that Mr. Winehouse and his group were shorting substantial amounts of Nu-Tech stock through Gundy & Co. through various nominees. The names of those nominees are currently unknown to me but can be revealed during discovery if we are permitted to take the depositions of Alexander Securities, Sun Coast Securities, Gundy & Co., Sharp, Grunthal, and others, and, most importantly, Mr. Winehouse himself.

On or about February 18, 1997, I again spoke to Marvin Feigenbaum, president of Nu-Tech, who advised me that a meeting had been held that day at Nu-Tech's offices at 500 Fifth Avenue, New York, New York. According to Mr. Feigenbaum, that meeting was attended by the defendant Winehouse, and other

gentlemen, including, Abe Silver, Sam Popack, Mr. Hagar, Stuart Kahan, and others.

At the meeting on February 18,1997, Mr. Feigenbaum had requested Mr. Winehouse and his group, which members Mr. Winehouse refused to identify, to stop shorting Nu-Tech stock. According to Mr. Feigenbaum, in order to stop the shorting of Nu-Tech stock, he offered Mr. Winehouse and his group to repurchase all Series A Convertible Preferred Stock for the fourteen million dollars which had been paid plus ten percent interest, and the short-sellers would be permitted to keep the profit they had made to date.

Mr. Feigenbaum advised me that he had told Mr. Winehouse and the other persons who were Series A Convertible Preferred shareholders at the meeting that Nu-Tech was due to receive the Bankruptcy Court's approval on April 18, 1997 to purchase Physicians Clinical Laboratory, Inc. ("PCL") in California and therefore he needed sixty days after the Bankruptcy Court approved the purchase of the laboratory on April 18, 1997, to raise the money to repay the Series A Convertible Preferred shareholders.

According to Mr. Feigenbaum, Mr. Winehouse refused to agree to this but instead advised Mr. Feigenbaum that it was not to Mr. Winehouse's personal benefit to resolve the dispute on those terms

and he would see to it that Mr. Feigenbaum did not have a future in the company--because his options at $7 and $11.50 would be worthless, to which Mr. Feigenbaum responded that, if necessary he would get his option plan reissued at $1. Mr. Winehouse also said he would see to it that the price of Nu-Tech stock would fall significantly.

Mr. Feigenbaum further advised me that the Board of Directors had designated Robert Fagenson and one other Board member to negotiate with Mr. Winehouse and the Reg. D holders.

Mr. Feigenbaum further advised me that the company would not give in to Mr. Winehouse's blackmail and would refuse to register the short-sellers" shares.

I then purchased another 8,350 shares of Nu-Tech stock on February 18, 1997 at 11-9/16.

I was later advised by Mr. Feigenbaum that another meeting had taken place on March 12, 1997 at the offices of Fagenson and Company, 19 Rector Street, New York, New York, and attending the meeting were Robert Fagenson, who is a member of the Board of Nu-Tech; Abe Silver; Mr. Popack; the defendant Winehouse; and Mr. Feigenbaum.

According to Mr. Feigenbaum, during this meeting, Mr. Fagenson asked Mr. Winehouse, who are you, your name does not appear in the list of the Reg. D. investors. Mr. Winehouse responded that he represented "some people", but refused to identify them. Mr. Fagenson, on behalf of Nu-Tech, sought to have Mr. Winehouse agree that he and his group would stipulate that their stock would be registered over a twelve-month period rather than immediately. Mr. Feigenbaum advised me that Mr. Winehouse refused to agree to this and stated he would continue to his short-selling activities and would drive the stock down until there was nothing left of Nu-Tech.

According to Mr. Feigenbaum, Mr. Winehouse also stated he would have an adverse article placed in Crane's Magazine which would adversely affect Nu-Tech stock, to which Mr. Fagenson replied he personally did not care what Mr. Winehouse because he only owned twelve thousand shares of Nu-Tech stock.

The very next day, March 13, 1997, the price of Nu-Tech stock dropped approximately three dollars and the day after that an additional three dollars. Apparently, Mr. Winehouse was making good on his threat to drive down the price of Nu-Tech.

Despite knowing all of this, the company said nothing about the meetings with Mr. Winehouse, the short-selling activities of the Series A Convertible Preferred Stock holders, until March 14, 1997 when the company issued a misleading press release stating that the company believed that the price decline of the stock could be attributed to "possible sales by shareholders" (Exhibit C).

This was obviously totally misleading. All the time Mr. Winehouse, whose name does not appear anywhere in the registration statement, was negotiating with Mr. Fagenson, a member of the Board of Nu-Tech, and Mr. Feigenbaum, its chairman. There were also communications between Mr. Winehouse's counsel and Nu-Tech's counsel; see for example, Exhibit B dated March 25, 1997, which communication fully supports what I had been told by Mr. Feigenbaum.

On March 18, 1997, I was contacted by Howard Weiss of Los Angeles, California, who is personally known to me and was also apparently friendly with Mr. Winehouse. Mr. Weiss advised me that he had Mr. Winehouse on the telephone as part of a conference call. Mr. Winehouse then stated he had heard I was upset with respect to what was taking place regarding his activities in Nu-Tech and wanted to know why I was upset.

I explained to Mr. Winehouse that his activities had caused the value of Nu-Tech stock to drop drastically and many innocent shareholders, such as myself and others who had purchased Nu-Tech stock, had been injured.

During this telephone conversation, Mr. Winehouse personally admitted to me, while Mr. Weiss was on the telephone, that he had arranged for four market makers, Sharp, Alexander Securities, Sun Coast Securities and Grunthal, to become market makers in Nu-Tech stock to enable Mr. Winehouse and his group to short unlimited amounts of Nu-Tech stock.

During this same conversation, Mr. Winehouse requested me to "calm down" and agreed to meet with me.

I then met with Mr. Winehouse at 9:00 a.m. the following morning, which I believe was March 19, 1997, at his offices under the name of Wall & Broad Equities. During this meeting, Mr. Winehouse admitted that he had manipulated the price of Nu-Tech stock and deliberately sought to short the stock to drive the price of the stock down; that he was going to continue to do so and advised me to get out and sell my Nu-Tech stock because the price of the stock was going to do down to "a dollar."

I advised Mr. Winehouse that there would be substantial losses to myself and other shareholders and that he should please cease his activities with respect to Nu-Tech stock.

Mr. Winehouse informed me that he could not cease his activities and that he could not worry about the other shareholders, but with respect to myself he would see to it that I was compensated for my losses.

Needless to say, I refused Mr. Winehouse's offer.

The reason Nu-Tech had a motive to conceal what was taking place between December 1996 and April 1997 was that in the interim, Nu-Tech was trying to buy another company known as Physicians Clinical Laboratory, Inc. ("PCL"), which company was in bankruptcy in the United States Bankruptcy Court for the Central District of California, case number CV-96-23185-GM.

That this purchase was troubling Nu-Tech is demonstrated in the March 25, 1997 letter from Mr. Winehouse's counsel (Exhibit B), specifically referring to no sales of stock taking place prior to the bankruptcy order in the PCL case becoming effective, and that there was an objection filed by the SEC in Bankruptcy Court with respect to the reorganization plan prepared by PCL and Nu-Tech (Exhibit B). Nu-Tech wanted nothing to occur which could interfere with its purchase of PCL

in the Bankruptcy Court in California which was scheduled for April 18, 1997.

In short, Mr. Winehouse and his group were manipulating Nu-Tech stock by having small brokerage firms become market makers in the stock so that they could short the stock without having available stock; Mr. Winehouse and his group were shorting the stock and manipulating the market prices for the stock while I, and other innocent investors, purchased Nu-Tech stock during the period November 7, 1996 to April 1, 1997, and Nu-Tech concealed what was going on because it was engaged in attempting to acquire PCL and if this information got out about its dispute with preferred shareholders who, in essence, could control the company, it could affect Nu-Tech's ability to buy PCL in the Bankruptcy Court.

I believe I have a valid claim against all the defendants in this case and the motions to dismiss should be denied in all respects.

S/_____

MORDECHAI GURARY

Sworn to before me this
20th day of August, 1997

S/_____

Notary Public

Memorandum Of Law Dated August 21, 1998 Submitted In Opposition To Defendants' Rule 12(b)(6) Motion

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

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MORDECHAI GURARY, 97 Civ. 3803

Plaintiff,

-against-

ISAAC WINEHOUSE, ISAAC WINEHOUSE d/b/a WALL & BROAD EQUITIES and NU-TECH BIO-MED, INC.,

Defendants.

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PLAINTIFF'S MEMORANDUM OF LAW IN OPPOSITION TO THE DEFENDANTS' MOTIONS TO DISMISS

PRELIMINARY STATEMENT

Plaintiff is submitting this Memorandum of Law in opposition to the motions to dismiss brought on by

both the Winehouse defendants and the Nu-Tech defendant. We will deal with each of the motions separately.

THE UNDERLYING FACTS

The underlying facts are basically set forth in the complaint and in Mr. Gurary's affidavit annexed hereto which show that Nu-Tech, a company whose shares are traded on the NASDAQ, attempted to raise money in order to purchase a company known as Physicians Clinical Laboratory, Inc. ("PCL"). All of this is set forth in Exhibit B to the moving papers by Nu-Tech. PCL was then in bankruptcy and under the supervision of the United States Bankruptcy Court in the Central District of California, case number SV 96-23185-GM.

Nu-Tech had had approximately two thousand eight hundred shares of stock outstanding in 1996 (Exhibit B to the moving papers, p. 6). In an attempt to raise money, Nu-Tech raised fourteen million dollars through a registration D placement, giving the investors of these Series A Convertible Preferred Stock the right to convert their preferred stock into Nu-Tech common stock at either $17.50 a share, or seventy five percent of the average closing price of the company's common stock as reported by NASDAQ for the five

trading days prior to the day that the holders converted.

As admitted by Nu-Tech (Exhibit B to the moving papers, p. 6), even at $1.25 a share which the stock was trading for in July 1997 [the stock is now trading for fifty cents], if the shares are converted, the company would not have enough common stock available to even issue common stock if all the convertible stock were to be converted, and the thirty-seven identified holders of Series A Convertible Preferred Stock would nominally own more than eighty percent [at today's price of fifty cents it would be more than ninety-two percent] of issued Nu-Tech stock, thus giving them virtual and actual control of the company.

As further noted, the identity of these thirty-seven people who purchased the Series A Convertible Preferred Stock are supposedly revealed on pages 28 and 29 of Exhibit B to the moving papers (Exhibit B to the affidavit of David Jaroslawicz). Significantly, Mr. Winehouse and his company, Wall & Broad Equities appear nowhere on this list of holders of the preferred stock.

It is alleged that Mr. Winehouse and his group started to short Nu-Tech stock—and it is clear that Mr. Winehouse was part of a group because if not, what

was he doing appearing on behalf of unidentified members of the group at various meetings with Nu-Tech as set forth in complaint, in Mr. Gurary's affidavit and as was admitted by Mr. Winehouse to Mr. Gurary as set forth in Mr. Gurary's affidavit.

At the time the Winehouse group started to sell Nu-Tech stock short, the stock was selling for approximately fifteen dollars per share; see complaint ¶13 showing purchases in November 1996 by Mr. Gurary). What the Winehouse group did was sell Nu-Tech stock short, knowing that in the future when the Series A Convertible Preferred Stock became registered, they would then be able to convert their preferred stock into common stock and have stock to cover their naked short position. It should be noted that by following this no-risk procedure, the defendants, in essence, violated Section 5 of the Securities Act of 1933, as made clear by the SEC's recent administrative proceeding in *GFL Ultra Financial Limited* (Exhibit A to Jaroslawicz affidavit).

The Winehouse group, by locking in a profit by selling securities short with the intent that the securities would be later registered to cover their short, were, in essence, taking all the risks out of the purchase and acting as a de facto distributor and underwriter.

It is alleged in the complaint and in Mr. Gurary's affidavit, and for the purposes of a motion to dismiss

must be taken as true and there is really no basis to doubt what is being said, that Mr. Gurary spoke to Mr. Feigenbaum, the president of Nu-Tech, who advised him of the negotiations between Nu-Tech and the Winehouse group and advised him that Nu-Tech was aware that the Winehouse group was shorting Nu-Tech stock.

In fact, the situation deteriorated to the point that Mr. Feigenbaum had Nu-Tech withdraw the registration of the Series A Convertible Preferred Stock to get the Winehouse group to stop shorting the stock because if they were not assured that they could get common stock by exchanging convertible preferred, they would have to buy back the stock they had shorted, in the open market.

According to the complaint and Mr. Gurary's affidavit, Mr. Winehouse admitted he had gotten four market makers, Alexander Securities, Sun Coast Securities, Sharp and Grunthal, to become market makers in the stock would permit his group to short unlimited amounts of stock. When one is not a market maker, a broker may not be short stock unless there is stock available to cover the short position. However, a market maker may short stock without having stock available to cover.

The situation continued to deteriorate so that other meetings were held and on March 12, 1997, during a meeting at Fagenson & Company at 19 Rector Street, New York, New York, attended by Robert Fagenson, a member of the Board of Nu-Tech, and others, Mr. Winehouse admitted he "represented" some people that he refused to identify and apparently advised the Board that he would continue to short Nu-Tech stock and actually did so to the point that Nu-Tech stock lost more than half its value during the next two days.

The plaintiff later had a conversation with Mr. Winehouse where Mr. Winehouse admitted that he had been shorting the stock and advised the plaintiff that he would continue to short Nu-Tech stock until the price would drop to a dollar, and that plaintiff should sell his Nu-Tech shares. Mr. Winehouse offered to somehow compensate the plaintiff for his losses in some improper manner, which offer the plaintiff refused, and Mr. Winehouse and his group continued to short Nu-Tech stock.

During this entire period, Nu-Tech concealed what was taking place, its friction with the Series A Convertible Preferred Stock holders, and the various meetings with Mr. Winehouse. One of the obvious reasons that Nu-Tech was doing so was that it was

about to purchase PCL in California and was seeking to avoid any public announcements which would affects its purchase of PCL in the Bankruptcy Court in California.

If there was ever any doubt about this, it is made clear by Mr. Gurary's affidavit and the March 25, 1997 letter from Heller Horowitz & Feit to Mr. Winehouse (Exhibit C to Jaroslawicz affidavit).

It must be remembered that we are not dealing with the issue of whether the plaintiff's allegations will be sustained at trial, or even if plaintiff's claims will survive a summary judgment motion after discovery. The only issue is whether the pleading is sufficient to identify the circumstances of the defendants' fraud and market manipulation so that defendants can prepare an adequate answer to the allegations.

It is well settled that a pleading's allegations of fraud is sufficient if it identifies the circumstances constituting fraud so that the defendant can prepare an adequate answer from the allegations. 5 Wright & Miller, *Federal Practice and Procedure:* Civil 2d § 1298 n.28 (1990)

POINT I

THE WINEHOUSE DEFENDANTS' MOTION TO DISMISS IS WITHOUT ANY MERIT

The motion to dismiss by the Winehouse defendants borders on the frivolous. It is supported by nothing but what appears to be a word-processor generated memorandum of law prepared for another case dealing with a material misstatements case rather than a market manipulation case and basically has nothing to do with the facts of this case.

Most disturbing is the lack of candor by defense counsel for Winehouse, who, if this case proceeds, may become witnesses in this action since they were intimately involved in negotiating with Nu-Tech on behalf of the Winehouse group (Exhibit C to Jaroslawicz affidavit).

Even more disturbing is that counsel for Winehouse seeks to mislead the Court. For example, on pp. 7-8 of their memorandum, counsel for Winehouse seems to indicate in footnote 2 that plaintiff only purchased one thousand shares of stock on October 31, 1996 and therefore could not have been affected by the convertible stock offering which occurred in November,

1996. This is willfully misleading since the complaint indicates that the plaintiff made additional purchases after October 31, 1996 of 5,500 shares on November 7, 1996; 1,000 shares on December 24, 1996, and 8,350 shares on February 18, 1997, purchases worth over totally $175,000. A lawyer has an obligation not to mislead the Court as to the facts or the law. *See, Cicio v. City of New York,* 98 A.D.2d 38, 469 N.Y.S.2d 467 (2d Dept. 1983).

The Winehouse motion claims that the plaintiff allegedly fails to show "how" the Winehouse defendants allegedly manipulated the price of Nu-Tech's common stock. This statement is obviously pure screed.

The complaint clearly alleges that the manner in which they manipulated the stock was by selling short stock which the Winehouse group did not own, intending to drive down the price of the stock and to cover that stock when they converted their Series A Convertible Preferred Stock into Nu-Tech common stock at a cheaper price and a locked in profit.

The law is crystal clear that someone who sells stock short prior to the effect of a registration statement and in anticipation of covering that with stock to be obtained pursuant to registered stock is manipulating the stock in violation of Rule 10-b-5. *See, Financial Invs.*

Corp., Exchange Act Release No. 10834 (May 30, 1947); and *Paul F. Newton & Co. v. Texas Commerce Bank,* 630 F.3d 1111, 1113-114 (5th Cir. 1980).

Winehouse's counsel attempt to turn this manipulation case into a material misrepresentation case because that straw man would be easier to defeat and would avoid discovery cannot change the facts that the Winehouse defendants are accused of manipulating Nu-Tech stock and that this is primarily a manipulation case as against the Winehouse defendants.

The Winehouse defendants are specifically accused of arranging for various brokers to become market makers to permit them to short unlimited amounts of stock; that the Winehouse defendants threatened the company to drive down the price of the stock and admitted this to Mr. Gurary (see Gurary affidavit); and that the Winehouse group of defendants began shorting the stock as soon as they became aware of and/or the holders of Series A Convertible Preferred Stock, intending to convert their shares into Nu-Tech common stock once the preferred stock became registered to cover their short position.

POINT II

PLAINTIFF HAS SET FORTH A PROPER CLAIM AS TO DEFENDANTS' MARKET MANIPULATION PURSUANT TO RULE 10b-5

Rule 9-b of the Federal Rules of Civil Procedure requires fraud to be pleaded with some specificity. It does not require a plaintiff, prior to discovery, to identify each fraudulent transaction which was part of a manipulative scheme, which the plaintiff could not possibly know prior to discovery.

Even in a misrepresentation case where the plaintiff has far more information, plaintiff is not held to an impossible burden. *See, Cosmas v. Hassett*, 886 F.2d 8 (2d Cir. 1989); *see also, In re Time Warner Securities Litigation*, 9 F.3d 259 (2d Cir. 1993).

The cases are also clear that where there are extensive transactions involved, such as there are in this market manipulation case where the defendants had numerous nominees whose names they have concealed to date, which engaged in numerous long and short stock transactions over an extended period of months, less specificity is required. *See, In re Olympic Brewing Co.*

Securities Litigation, 674 F. Supp. 597, 620 (N.D. Ill., 1987).

In what appears to be the leading case spelling out the difference between a material misrepresentation case and a market manipulation case under Rule 10-b-5 in the Southern District of New York, *In re Blech Securities Litigation*, 928 F. Supp. 1279 (S.D.N.Y. 1996), Judge Sweet of this Court set forth the legal standards for a market manipulation case.

As Judge Sweet explained, market manipulation is designed to deceive or defraud investors by controlling or artificially affecting the price of securities, citing *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 199, 96 S.Ct. 1375, 1384 (1976). As Judge Sweet, pointed out:

> . . . market manipulation claims present circumstances in which the mechanism of the scheme is likely to be unknown to the plaintiffs. Time, place, and content requirements have been set out by the Court of Appeals and the district courts primarily where complaints involve misrepresentation and where the plaintiffs thus had access to such details or where, in the case of market manipulation, discovery had progressed to a fair extent. *See Shields*, 25 F.3d at 1128; *DiVittorio*, 822 F.2d at 1247; *Browning Ave.*,

> 774 F. Supp. at 138. In the case at bar, where the principal allegations of wrongdoing involve market manipulation rather than false statements, the Complaint sets forth a sufficient level of detail by alleging the nature, purpose, and effect of the fraudulent conduct and the roles of the defendants. Although it does so in broad strokes, at this stage no more can be required to give Defendants fair notice of Plaintiffs' claims and thereby to satisfy Rule 9(b).

The cite to *Blech* is conspicuously absent from the memorandum of law submitted by counsel for the Winehouse defendants to this Court.

Plaintiff's complaint clearly sets out the scheme where the Winehouse defendants manipulated the market by selling short Nu-Tech stock, not in a legitimate expectation that the stock would decline in price, which would be a legitimate short-sale because if the price of the stock increased, the short sale would be at risk, but instead the Winehouse group sold Nu-Tech stock short confident that when the Series A Convertible Preferred stock was finally registered, they would use that as yet unregistered stock to cover the short sale. Thus, the Winehouse group had an incentive to drive the price of the stock as low as possible, which

Mr. Winehouse admitted to the plaintiff (see Gurary affidavit).

The Winehouse group also, in essence, manipulated the price of Nu-Tech stock by willfully seeking to drive it down in order to be able to cover their short by converting the shares for as low a price as possible; the difference between the price at which they sold their shares through various unknown nominees and the price at which they bought back their shares would be their profit.

The fact that the Winehouse group used various nominees and that Mr. Winehouse's name appears nowhere as a Series A Convertible Preferred Stock holder is likewise extremely strong indicia that these defendants were manipulating the market in Nu-Tech securities.

POINT III

THE ARGUMENT THAT PLAINTIFF DID NOT BUY DURING THE TIME PERIOD OF THE MARKET MANIPULATION IS FRIVOLOUS

Plaintiff's complaint sets forth four specific purchases of Nu-Tech stock—see ¶13—between October 13, 1996 and February 18, 1997, at prices between 11 9/16 and 15 ½. It was during that time period that it is alleged the Winehouse defendants began their manipulation of the price of Nu-Tech stock so that, in essence, while the Winehouse group was selling Nu-Tech stock, the plaintiff and other innocent purchasers, were buying it, not knowing that the Winehouse group was engaging in short-selling through various nominees in an attempt to drive down the price of the stock.

The Winehouse defendants' reference to the March 14, 1997 misleading press release by the company is sheer screed. That press release was intended to simply demonstrate that ***even after*** Nu-Tech clearly knew and had met with the Winehouse group and had absolute knowledge of the reason why the stock was being crushed in the market, it still issued a false press release to cover up what was taking place, and did not reveal the meetings with Mr. Winehouse or that the short sellers who were the holders of Series A Convertible Preferred Stock were driving the price of its stock down.

Counsel for the Winehouse defendants is correct that short-selling stock and inducing a broker to

become a market marker are by themselves not illegal acts. Similarly, owning a gun and going into a bank are not illegal acts. However, going into bank with a gun and using that gun for a hold-up is an illegal act. Similarly, in our case, selling stock short without risk because the short sellers intended to use as yet unregistered stock, which they would obtain later as part of convertible preferred stock, in order to cover their short is an improper act. *See, Financial Invs. Corp., Exchange Act Release No. 10834* (May 30, 1947; and *Paul F. Newton & Co. v. Texas Commerce Bank,* 630 F.3d 1111, 1113-114 (5th Cir. 1980). *See also,* SEC ruling 3-9333 (Exhibit A to Jaroslawicz affidavit). Having market makers become market makers in stock not for a legitimate reason but simply to assist the Winehouse group in shorting the stock constitutes a manipulating act which is illegal under Rule 10-b-5.

As previously pointed out the memorandum of law prepared by defense counsel appears to be word-processor generated, cut and paste job, dealing with a material misrepresentation case and has nothing to do with a market manipulation case to the extent that it does not even cite the lead case in this district involving market manipulation which is Judge Sweet's decision in *In re Blech Securities Litigation, supra.*

Plaintiff has clearly pleaded fraud sufficiently as against the Winehouse defendants, that they manipulated the market which Mr. Winehouse admitted to the plaintiff (see Gurary affidavit) and any claim that these defendant do not know what they are being accused of in light of Mr. Gurary's affidavit is pure screed. It is plaintiff's belief that the defendants have simply brought on this motion in an attempt to delay discovery while they cover their short-sales through the conversion of their preferred stock by reason of the recent registration of the Series A Convertible Preferred Stock.

POINT IV

PLAINTIFF HAS SET FORTH A CLAIM UNDER SECTION 349 OF THE GENERAL BUSINESS LAW

Both defendants claim that a securities fraud claim may not be brought under Section 349 of the New York General Business Law ("GBL §349"), citing various district court cases. The defendants do not cite the leading Second Circuit case involving GBL §349 which was decided later than all of the cases other than

perhaps one of the cases, and which makes it clear that a valid claim under GBL §349 can be pleaded where anyone is defrauded and the public welfare is at stake as it clearly is when the price a security is manipulated on the public market. *See Securitron Magnavision v. Schnabolk*, 65 F.3d 256 (2d Cir. 1995).

In any event plaintiff's GBL §349 claim is not the plaintiff's primary claim and the defendants are correct that if this Court does not have jurisdiction pursuant to the Federal Securities Law, then plaintiff's GBL §349 claim should be relegated to the State Court, as should plaintiff's common law fraud claim, which plaintiff will bring in the State Court if, for any reason, this Federal securities claim is dismissed.

However, under *Securitron*, which is the Second Circuit's standard for interpreting GBL §349, a proper claim has been made out.

POINT V

THE MOTION BY NU-TECH TO DISMISS IS WITHOUT ANY MERIT

Nu-Tech has filed a more sophisticated motion than the Winehouse defendants based on five points and is sheer sophistry.

The major point alleged by Nu-Tech is sheer sophistry. Nu-Tech alleges that the plaintiff cannot show that his injury is "in connection with the purchase or sale of any securities." There is no question that in order to make out a valid claim pursuant to 10(b) and Rule 10-b-5, it must be in connection with the purchase or sale of a security.

Plaintiff in this complaint, ¶13, alleges four specific purchases between October 13, 1996 and February 18, 1997 of 15,850 shares. Although it is irrelevant, Mr. Gurary's affidavit makes it clear that he is currently the holder of 36,400 shares of Nu-Tech stock.

Counsel for Nu-Tech has constructed a straw man that because the plaintiff has attached to the complaint a copy of a press release finally issued on March 14, 1997 to demonstrate that Nu-Tech's

management—even after actually meeting with Winehouse and his group and having Nu-Tech's attorneys negotiate with Winehouse's attorneys (Exhibit C)—was still seeking to mislead the public as to the concerted effort to short Nu-Tech stock by the Winehouse group, which they were fully aware of, but instead falsely stated that there was only a supposition that there might be "possible shares by shareholders."

At no time does the complaint indicate that plaintiff relied upon this false press release in purchasing his shares, all of which were purchased before the press release. The press release was simply attached to the complaint to indicate the extent and extremity of Nu-Tech's attempt to conceal from the public and the Bankruptcy Court in California what was taking place with respect to Nu-Tech stock so as not to interfere with Nu-Tech's purchase of PCL in the Bankruptcy Court in the Central District of California, and this is supported by the letter from Mr. Winehouse's attorneys to Mr. Winehouse (Exhibit C to Jaroslawicz affidavit).

The complaint makes it clear that Mr. Feigenbaum, the president of Nu-Tech, was aware of the Winehouse defendants' short-selling activities and had called Mr. Winehouse in December 1996 to request him to stop short-selling Nu-Tech stock, which he had

an obligation to reveal to the public as to what was taking place.

The complaint also makes it clear that Nu-Tech held a meeting with Mr. Winehouse at Nu-Tech's office on February 18, 1997 which numerous persons attended, including Nu-Tech's president, Mr. Feigenbaum, Mr. Winehouse, and others, and once again the Winehouse group was requested to stop shorting Nu-Tech stock.

Another meeting was held on March 12, 1997 at the offices of Fagenson and Company attended by Mr. Winehouse, Mr. Feigenbaum and Mr. Fagenson, a member of Nu-Tech's Board of Directors.

Since the complaint clearly alleges that by December 1996 Nu-Tech and its president, Mr. Feigenbaum were aware of the Winehouse group's activities and, in fact, had withdrawn the registration of the Series A Convertible Preferred Stock because of the short-selling activities, and that Mr. Feigenbaum had met with Mr. Winehouse at Nu-Tech's office in an attempt to stop the short-selling, it is crystal clear that at least the 8,350 shares purchased by the plaintiff on February 18, 1997 for 11 9/16 per share, as well as the purchase on December 24, 1996 of 1,000 shares at 11 3/4 were done ***after*** Mr. Feigenbaum was aware of the Winehouse group's short sales and he had an

obligation to reveal this highly critical information to the investing public, including the plaintiff.

The argument that because the plaintiff attached to the complaint a later press release to demonstrate that the defendant continued to conceal the true state of affairs even as late as March 14, 1997, therefore the plaintiff is somehow claiming to rely on the March 14, 1997 press release for his prior purchases, is absurd on its face and no such allegation was ever made by the plaintiff.

At no time did plaintiff claim that this March 14, 1997 release caused him to purchase shares prior to that date.

What the plaintiff does claim is that since December 1996 (see complaint, ¶28), Mr. Feigenbaum, President of Nu-Tech, was fully aware of the short-selling going on by the Series A Convertible Preferred stock and failed to reveal this and its consequences to the public.

It is plaintiff's position that when there is material information in the hands of management such as that a group who will control the corporation once it converts convertible stock is deliberately selling the stock short to drive down the price of the stock and there have been meetings between the company and

the short sellers, the company has an obligation to alert the public as to what is taking place rather than to permit persons to purchase stock not knowing that there is a manipulation of the stock price going on and the stock which they are innocently purchasing is very possibly being sold to them by the short-sellers who are manipulating the market price and that the price will, in fact, be driven down, and that management has been so informed.

Plaintiff also does not allege that Nu-Tech was initially part of the short-selling scheme. Plaintiff does allege that once Nu-Tech knew of the scheme, this was material information which the public and the plaintiff had a right to know and Nu-Tech management had an obligation to reveal, rather than to conceal it because of its intended purchase of PCL.

The argument that Nu-Tech did not profit by the short-selling is agreed to by the plaintiff. There is no claim that Nu-Tech profited. It was the Winehouse group that profited from the short-selling.

As Nu-Tech counsel argues, Nu-Tech may originally have been a victim of the Winehouse group's manipulation. However, Nu-Tech had an obligation, once it learned of the manipulation, to alert the public, including the plaintiff, and not to conceal it.

Similarly, the argument made by defense counsel that plaintiff was a "beneficiary" of the Winehouse scheme because the stocks he purchased on December 24, 1996 and February 18, 1997 were purchased at a price slightly lower than he would have purchased them otherwise is likewise frivolous and offensive.

The plaintiff, on December 24, 1996 paid 11 3/4 for his 1,000 shares, and on February 18, 1997 paid 11 9/16 for 8,350 shares. At that time, the short-sellers had only started their short-selling campaign, so although plaintiff may have purchased the stock at a slight discount to what he would have purchased it were the stock price not manipulated, in fact, the plaintiff was the victim of a manipulation scheme when the stock he was caused to buy at an inflated value would soon fall dramatically once the defendants continued to carry out their scheme, and it is in fact highly likely that the share purchased by the plaintiff were, in fact purchased from the short sellers. The amount of plaintiff's loss is a matter of proof for trial.

The Nu-Tech stock is currently selling for fifty cents per share. The defendant's argument that the plaintiff must allege that he sold his shares if not he only suffered a "paper loss" is frivolous and supported by no authority whatsoever.

Nu-Tech's counsel adopts a formal and formalistic approach that plaintiff somehow had to specifically allege that management of a public company was under a duty to disclose material facts. If this ritualistic recitation is all that is bothering Nu-Tech's counsel, we will be happy to plead it in an amended complaint which would be a waste of time for all concerned. We believe it is now beyond cavil or argument that management of a public company has a duty to promptly disclose material information to the public which might affect its decision to purchase or sell securities.

It is also no longer open to any serious question that a public company that fails to reveal the real reason its stock is plummeting and continues to conceal it (see press release March 14, 1997 annexed to the complaint) is concealing material information. *See, TSC Industries v. Northway, Inc.*, 426 U.S. 438 (1976).

The argument made by the defendant that short-selling and the decline in price is natural and lawful is likewise misleading. As previously pointed out, there is nothing wrong with short-selling. What is wrong is manipulating the price of a stock by short-selling under the names of various nominees and through various brokerage firms to conceal who is doing the short-selling and the amount of the short-selling, and to sell

short without any risk because the short-sellers are, in fact, going to cover once the convertible stock is converted into common stock.

In this case, we have specific admissions by Nu-Tech's president, Mr. Feigenbaum, to the plaintiff as to what was taking place and the various meetings between the Winehouse group and Nu-Tech, and admittedly there was a failure to reveal anything at all until March 14, 1997 when the misleading press release was finally issued and which continued to conceal the real reason for the drastic drop in Nu-Tech's stock.

POINT VI

PLAINTIFF HAS A VALID CLAIM FOR INJUNCTION RELIEF

As the Court may recall, there was a conference where the plaintiff requested a temporary restraining order which the Court denied.

Nu-Tech has now gone ahead and registered the Series A Convertible Preferred Stock. Pursuant to Nu-Tech's own registration statement and the convertible shareholders now control more than eighty percent of

the company and the price of Nu-Tech has fallen to fifty cents.

The plaintiff, who is still a shareholder of 36,400 share of Nu-Tech stock, has an absolute right to seek injunctive relief. Although it may now be too late to prevent the shares from being registered, plaintiff may seek injunctive relief to prevent the Winehouse group from realizing their ill-gotten gains should that become necessary after discovery has been had.

CONCLUSION

For all the above reasons, it is respectfully request that:

(a) the defendant's motions to dismiss be denied in all respects and the defendants directed to answer and the case to proceed to discovery without any further delay;

(b) if for any reason the Court finds a technical pleading deficiency, plaintiff should be granted an opportunity to amend the complaint; as pointed in the Gurary affidavit, it is clear the plaintiff has a valid claim which should not be dismissed without leave to replead if there is a technical pleading deficiency;

(c) the Court award such other and further relief as to this Court may seem just and proper.

Dated: New York, New York
August 21, 1997

Respectfully submitted,

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UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

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MORDECHAI GURARY,	Docket nos.
Plaintiff-,	98-7239(L)
Appellant-	98-7280(XAP)
Cross-Appellee	

-against-

ISAAC WINEHOUSE, ISAAC WINEHOUSE d/b/a WALL & BROAD EQUITIES

Defendants-
Appellees.

-and-

NU-TECH BIO-MED, INC.,

Defendants-
Appellees-Cross-
Appellants.

----------X

REPLY BRIEF OF PLAINTIFF-APPELLANT-CROSS-APPELLEE GURARY

PRELIMINARY STATEMENT

The facts of this case are rather simple. Plaintiff lost nearly half a million dollars investing in Nu-Tech Bio-Med, Inc. ("Nu-Tech") stock.[1]

Plaintiff claims that during the period that plaintiff was buying Nu-Tech stock, the Winehouse group of defendants was manipulating the price of the stock by short-selling through the secret accounts of various nominees, both in the United States and outside the United States, to drive down to stock price, which constitutes a market manipulation and which should be sufficient to uphold even a criminal conviction, much less a civil complaint, as this Court made clear in *U.S. v. Regan*, 937 F.2d 823, 829 (2d Cir. 1995); and *U.S. v. Russo*, 74 F.3d 1381, 1389 (2d Cir. 1996).

Plaintiff further alleges that Nu-Tech and its president Marvin Feigenbaum were totally aware of the

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[1] Nu-Tech stock, which traded at sixteen dollars per share in November 1996, is now trading at approximately three cents, when a buyer can be found.

scheme and that Nu-Tech's president Feigenbaum told the plaintiff that Nu-Tech would refuse to register the Winehouse group's shares, as a direct result of which plaintiff purchased an additional 8,350 shares at 11 9/16 on February 18, 1997 (A9, A138[2]) and 1,000 shares on December 24, 1996.

In fact, contrary to the representations made to the plaintiff, Nu-Tech registered the Winehouse group's shares and plaintiff suffered an extremely substantial loss.

We are also submitting this brief in opposition to Nu-Tech's cross-appeal seeking sanctions.

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[2] All page references are to the Appendix unless otherwise indicated.

POINT I

PLAINTIFF'S COMPLAINT SETS FORTH A CLAIM AGAINST THE DEFENDANTS WINEHOUSE AND WALL & BROAD EQUITIES FOR MANIPULATING THE MARKET IN NU-TECH STOCK

The details of the defendants' scheme need not be repeated here. However, in order to lock in the cheaper price once the Winehouse defendants believed they would own Nu-Tech stock as part of a Series A convertible preferred stock, they used the names of various nominees in the united States and abroad in order to short Nu-Tech stock.

Pursuant to the rules of the NASD, including IM-3350 which prohibits short sales unless there is stock available to cover, Winehouse arranged to have various persons become market makers in Nu-Tech stock so that they could continue to short as much stock as was necessary in a conspiracy to manipulate and depress the price of Nu-Tech stock.

The plaintiff's complaint was dismissed before the plaintiff had an opportunity to take Winehouse's deposition and to determine what, if anything,

Winehouse ha to do with Nu-Tech, what stock he had shorted through which nominees and through which brokerage houses. Winehouse's name appears nowhere on the list of Series A convertible preferred stock shareholders (A55-56). It is also clear that Winehouse was the moving force and controlled many of the investors in the Series A convertible preferred stock as made clear by the letter dated March 25, 1997 (A144-45).

The Winehouse defendants in their brief totally ignore the applicable law and deal with this case as if it were a misrepresentation case rather than a market manipulation case.

The Supreme Court has advised us to interpret Section 10(b) and Rule 10b-5 expansively in order to minimize fraud in securities trading, and has made it clear that novel or atypical methods of fraud should not be provided immunity from securities laws. *See Superintendent of Insurance v. Life & Casualty Co.*, 404 U.S. 6, 11, 92 S.Ct. 165 (1971); see *also A.T. Brod & Co. V. Perlow*, 375 F. 2d 397 (2d Cir. 1967).

In *U.S. v. Regan*, 937 F.2d 823 (2d Cir. 1991), this Court upheld a criminal conviction for short sales which concerned who the seller or the moving party behind the trades was, 937 F2d at 329, and pointed out

that Rule 10b-5 bars the use of any manipulative or deceptive devices. This Court went on to state:

> Congress meant to prohibit the full range of ingenious devices that might be used to manipulate securities prices. *Santa Fe Indus. v. Green,* 430 U.S. 462, 477, 97 S. Ct. 1292,1303, 51 L.Ed. 2d 480 (1977). For an informative discussion of the diverse devices that ingenious minds have conceived, see 3 Bromberg & Lowenfels, *Securities Fraud and Commodities Fraud §7.2(220) - (227).* 937 F.2d at 829.

In *Regan* this Court further stated:

> Failure to disclose that market prices are being artificially depressed operates as deceit on the market place and is an omission of a material fact. 937 F.2d at 829

In our case as in *U.S. v. Regan,* defendants used short-selling under various secret and undisclosed names and arranged for certain brokers to become market makers in Nu-Tech stock in order to manipulate the price of the stock to drive it lower so as to profit once they came into possession of their convertible preferred stock.

In another case upholding a criminal conviction for short-selling involved as part of a manipulation

scheme, *U.S. v. Russo,* 74 F. 3d 1383, 1389 (2d Cir. 1996), this Court stated in language directly applicable to our case:

> Given the weight of the case law and our mandate to interpret Rule 20b-5 expansively, we conclude that the fraudulent short sales made for the express purpose of financing the appellants' stock kiting scheme served as a fraud on the market for Lopat and EAS stock. We therefore find that the short sales were sufficiently connected to the manipulation scheme as to constitute a violation of Section 10(b) and Rule 10b-5. 74 F.3d at 1392.

In our case, the defendants' conduct is enough to uphold even a criminal conviction much less a civil complaint, assuming all the facts alleged in the complaint are true and they must be taken as true for the purposes of a motion to dismiss.

The Third Circuit in *Pittsburgh Terminal Corp. v. The Baltimore & Ohio Railroad Co.,* 680 F.2d 933 (3d Cir. 1982), likewise made it clear that Rule 10b-5 prohibits any manipulative or deceptive device no matter how artful, original or different than the usual fraudulent scheme might be. In that case the defendant arranged to fix a date for the declaration of a stock dividend and also the same record date for participation in a valuable stock dividend with the obvious intent of preventing

plaintiffs from participating in the stock dividend. The Third Circuit found that this was a manipulative and deceptive device and reversed the dismissal of the plaintiff's complaint.

The cases cited by the Winehouse defendants in their brief such as *In re Scattered Corp. Sec. Litig.*, 844 F. Supp. 416 (N.D.I11. 1994), aff'd., 47 F. 3d 857 (7th Cir.), cert. denied, 516 U.S. 818 (1995), and *In re Olympia Brewing Co. Sec. Litig.*, 613 F. Supp 1286, 1292 (N.D. I11. 1985), for the proposition that short-selling itself is legal are totally beside the point.

There is no dispute here that short-selling by itself is legal. It is when one uses short-selling by itself is legal. It is when on uses short-selling as part of a manipulative scheme, using the names of various nominees and through brokers who became market-makers for a limited period of time solely for the purpose of permitting unlimited short-selling by the Winehouse group to drive down and manipulate the price of the stock, that it is illegal and that is exactly what is being alleged here.

Supreme Court, U.S.
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No. 00-1908

IN THE

Supreme Court of the United States

MORDECHAI GURARY,

Petitioner,

v.

UNITED DIAGNOSTIC, INC.,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF IN OPPOSITION

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Parties to the Proceeding (Rule 14.1(b))

The petition in part accurately lists the original parties to the proceedings below, but does not accurately list the parties as they exist today. Nu-Tech Bio-Med, Inc. no longer exists, and did not exist at the time of the proceedings and judgment in *Gurary v. Winehouse*, 235 F.3d 792 (2d Cir. 2000), from which the petition is taken. United Diagnostic, Inc., named as respondent in the caption of this brief in opposition, is the successor by corporate merger to Nu-Tech Bio-Med, Inc.

Additionally, the petition incorrectly identifies the petitioner. Mordechai Gurary, named as petitioner, was the plaintiff in the original action instituted in the district court. This petition involves only the imposition of sanctions on Gurary's counsel, pursuant to Fed. R. Civ. P. Rule 11(b) and Section 21D(c)(1) of the Private Securities Litigation Reform Act of 1995, 15 U.S.C. § 78u-4 *et seq.* Accordingly, Gurary no longer has any interest in this proceeding, and the correct petitioners are those counsel, David Jaroslawicz, Esq., and his law firm, Jaroslawicz & Jaros.

Corporate Disclosure Statement (Rule 29.6)

Respondent United Diagnostic, Inc. is a Delaware corporation whose securities are publicly-held but are not currently listed on any exchange. It has no publicly-owned corporate parents, subsidiaries, or affiliates. As noted in the foregoing Rule 14.1(b) Statement, United Diagnostic, Inc., is the successor-in-interest by corporate merger to one of the original defendants in the case, Nu-Tech Bio-Med, Inc.

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STATEMENT OF THE CASE

Respondent United Diagnostic, Inc. ("UDI"), successor to Nu-Tech Bio-Med, Inc. ("Nu-Tech"), submits this brief in opposition to the petition for a writ of certiorari to the United States Court of Appeals for the Second Circuit of petitioners David Jaroslawicz, Esq., and his law firm, Jaroslawicz & Jaros (hereinafter collectively, "Jaroslawicz").[1] Jaroslawicz seeks the writ to review a judgment of the circuit court (a) awarding UDI sanctions against him under Fed. R. Civ. P. 11(b) and under the sanctions provisions, 15 U.S.C. § 78u-4(c)(1)-(3), of the Private Securities Litigation Reform Act of 1995 (the "PSLRA"), 15 U.S.C. § 78u-4 *et seq.*, and (b) remanding the case to the United States District Court for the Southern District of New York for determination of the amount of those sanctions. On remand, and while this petition was pending, the district court, by opinion and order dated August 1, 2001, awarded UDI sanctions against Jaroslawicz in the amount of $62,556.28.

Jaroslawicz's sole argument is that the court of appeals factually erred in imposing sanctions for frivolous securities law claims that Jaroslawicz now asserts were never lodged against UDI. The determination he challenges in this Court is thus

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[1] As noted in UDI's preceding Rule 14.1(b) Statement, the petitioner is incorrectly identified in the petition as Mordechai Gurary, who was the original plaintiff in the action in the district court.

factbound; he asks this Court to grant the writ to correct a purported factual error. Moreover, although he could have done so, Jaroslawicz failed to advance the argument he advances in this Court in two separate plenary appeals in the court of appeals.

The court of appeals' decision relied on settled principles of federal securities law, under case law and statute. Jaroslawicz's petition neither specifies nor even alludes to any conflict (much less an important one) between the decision of the court of appeals here and any decision of this Court, or between decisions of the circuit courts, that requires this Court's intervention. Similarly, the petition raises no serious and substantial question of federal law, or one relating to the administration of justice, that would mandate issuance of the writ. The petition should be denied.

A. The Facts.

Gurary alleged that he had made four open market purchases of the securities of UDI's predecessor Nu-Tech, each of which assertedly gave rise to claims under the securities laws against Nu-Tech and its co-defendants Isaac Winehouse and "Isaac Winehouse doing business as Wall & Broad Equities." (App. 68, 69) On his client's behalf, Jaroslawicz set forth two different theories of relief against Nu-Tech, either in the complaint or in defending the complaint against attack in the district court and in the court of appeals.

Common to both theories, Jaroslawicz alleged that the market for Nu-Tech's common stock, which was traded at the time on the NASDAQ exchange, was adversely affected by a "short selling" scheme in which defendants other than Nu-Tech had conspired to use Nu-

Tech's convertible securities to manipulate the market for its common stock. Both theories were predicated on the underlying fact that the Winehouse defendants were holders of Nu-Tech convertible preferred securities. These gave the Winehouse defendants the right to convert into Nu-Tech common stock and, according to Gurary, fueled these defendants' ability to profit by their short-selling scheme as it gave them "cheap stock" to "cover" their short sales. Because the conversion to common stock was made at a discount to market, the conversion formula effectively guaranteed a profit to the Winehouse defendants from their scheme, with no substantial risk.[2]

Jaroslawicz did not allege, however, that Nu-Tech was a direct or indirect participant in this scheme. Instead, in the complaint that he signed, Jaroslawicz posited that Nu-Tech was liable because it failed to disclose what it allegedly knew of the scheme. Later, in response to Nu-Tech's motion to dismiss, Jaroslawicz argued that Nu-Tech was liable because its president

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[2] "A short sale involves a seller agreeing to sell stock it does not own . . . ." *United States v. Russo*, 74 F.3d 1383, 1388 (2d Cir. 1996). *See also United States v. Manko*, 979 F.2d 900, 903 (2d Cir. 1992). If he is to profit, the seller must "cover" at a price lower than the sale price; that is, he must buy stock at a price lower than the short sale price to satisfy the short sale by making delivery on the contract to sell. *See* DICTIONARY OF FINANCE AND INVESTMENT TERMS 82 (2d ed. 1987). Gurary's theory was that the Winehouse defendants engaged in manipulative short selling, and then "covered" with common stock obtained through discounted conversions.

allegedly promised to frustrate the scheme, and did not. Based on these two theories, Gurary sought to recover for the decline in the value of the securities he had purchased on four separate occasions, from October 31, 1996, through February 18, 1997. (App. 71 ¶ 13; App. 79-80 ¶¶ 47-52)

B. Course of Proceedings Below.

Mordechai Gurary filed the original action on May 23, 1997, in the United States District Court for the Southern District of New York. His complaint (App. 68), signed by Jaroslawicz pursuant to Fed. R. Civ. P. 11(a), alleged violations of Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), and Rule 10b-5 promulgated thereunder, 17 C.F.R. § 240.10b-5, as well as violation of New York statutory law. The district court granted summary judgment to defendants, and dismissed the complaint (App. 1-8), and Jaroslawicz filed a notice of appeal on behalf of his client to the United States Court of Appeals for the Second Circuit. The district court also denied sanctions to UDI under Rule 11 and the PSLRA, and UDI filed a notice of cross-appeal.

By written opinion dated August 24, 1999, the court of appeals affirmed the district court's dismissal of the complaint, and reversed the denial of sanctions, holding that the district court had failed to make the sanctions findings mandated by 15 U.S.C. § 78u-4(c)(2). *Gurary v. Winehouse*, 190 F.3d 37 (2d Cir. 1999) ("*Gurary I*") (App. 9-34). Because the district court had failed to comply with the statutory mandate, the court of appeals remanded so that the district court could make such findings in the first instance. On remand, the district

court once again denied sanctions, this time rendering written findings of fact and conclusions of law. (App. 35-38) UDI filed a second notice of appeal to the United States Court of Appeals for the Second Circuit.

The second appeal was limited to the issue of sanctions, and UDI was successful in obtaining a direction for the imposition of sanctions. By published opinion dated December 19, 2000, the court of appeals held that of the four securities trades that Jaroslawicz on his client's behalf had specified as the basis for the claims, two were insupportable in law and in fact, and thus violated Fed. R. Civ. P. 11(b). The court of appeals remanded for the determination of the amount of the sanctions. *Gurary v. Winehouse*, 235 F.3d 792 (2d Cir. 2000) ("*Gurary II*") (App. 39-65). While the petition in this Court was pending, on August 1, 2001, the district court imposed sanctions on Jaroslawicz in the amount of $62,556.28. *Gurary v. Winehouse*, 97 Civ. 3803 (LLS), 2001 WL 876912 (S.D.N.Y. Aug. 2, 2001). Jaroslawicz did not seek a stay of the mandate of the court of appeals in *Gurary II*, either here or in that court.

Jaroslawicz timely moved for rehearing and rehearing *en banc* before the court of appeals, and that court denied the motion. (App. 66-67) Jaroslawicz filed his petition for a writ of certiorari on May 29, 2001, and it was placed on the docket on June 21, 2001. UDI's date to respond was extended by the Clerk of the Court to August 20, 2001. This Court has jurisdiction over the petition pursuant to 28 U.S.C. § 1254(1).

C. The Decision of the Court of Appeals in *Gurary I*.

The court of appeals in *Gurary I* affirmed the dismissal of the federal securities law claims predicated on Gurary's purchases of Nu-Tech securities. The court began by noting that the one contention which Gurary had continued to press on appeal as against Nu-Tech was that he was:

> deceived in making his December 24, 1996 and February 18, 1997 purchases because he relied upon Feigenbaum's [Nu-Tech's president] declarations that Nu-Tech would not register the common [stock] into which the Winehouse group's [the other defendants and their alleged co-conspirators] preferred was convertible and that this should or would stop it from selling the common short.

Gurary I, 190 F.3d at 44; App. 24.[3] The court of appeals squarely rejected the contention that this theory provided adequate factual or legal support for a Section 10(b) and SEC Rule 10b-5 claim.

The court first noted that "this theory is not the basis of the Rule 10b-5 claim against Nu-Tech set forth in the complaint and in Gurary's affidavits, which in essence was that Nu-Tech had failed to disclose what it

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[3] The court noted that Gurary had "abandoned any other claims against Nu-Tech." *Id.* n.7.

knew of Winehouse's activities." *Id.* The court accordingly held that because Gurary had "failed to make [this] argument to the district court, [he] will not be heard to advance it here." *Id.* (citations omitted). Nonetheless, the court of appeals proceeded to examine the argument, and held that "[e]ven if the argument were properly before [the court], . . . it would lack merit." *Id.*

The court of appeals observed that the statements on which the argument were based were "in the future tense" and "were ones of intention or of a promissory nature." *Id.* The court therefore relied on a fundamental tenet of the law of securities fraud—that "[t]he failure to carry out a promise made in connection with a securities transaction is normally a breach of contract. It does not constitute fraud unless, when the promise was made, the defendant secretly intended not to perform or knew that he could not perform." *Id.* (citing *Mills v. Polar Molecular Corp.*, 12 F.3d 1170 at 1176 (2d Cir. 1993)).[4] The court proceeded to note that because "there is no suggestion in the complaint or in Gurary's affidavit that Feigenbaum did not intend to do just what he promised at the times he made the statements to which Gurary now points . . . [,] the claim now advanced against Nu-Tech is

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[4] This theory—of fraudulent intention not to perform a contract to buy or sell a security—was recently sustained by this Court, as an available theory of recovery in Rule 10b-5 litigation, in *The Wharf (Holdings) Limited v. United International Holdings, Inc.*, ____ U.S. ____ , 121 S.Ct. 1776, 149 L.Ed. 2d 845 (2001). There is, of course, no occasion to revisit it here.

fundamentally flawed . . . [and] was properly dismissed . . . ." *Id.*

After affirming the dismissal of the only claims against Nu-Tech that Gurary had pressed in the court of appeals, the court of appeals proceeded to examine the Rule 10b-5 claims that Gurary pressed against the Winehouse group, Nu-Tech's co-defendants. As noted above, these were generalized claims of a market manipulation accomplished through a short-selling scheme. The court of appeals' disposition of these claims was relevant to *Gurary II*, the appeal limited to the sanctions issues, and is relevant to the issues presented by the petition here, because Gurary originally pressed such theories and claims against Nu-Tech as well in the district court, alleging a violation of Rule 10b-5 by reason of Nu-Tech's supposed knowledge of and failure to disclose the manipulative scheme. But if the underlying scheme did not amount to a Rule 10b-5 claim, the failure to disclose it, even assuming any duty to do so, likewise did not amount to such a claim. The sufficiency *vel non* of those theories were therefore pertinent to the Rule 11 inquiry in *Gurary II*.

Turning first to Gurary's "last two purchases of Nu-Tech shares, which occurred on December 24, 1996 and February 18, 1997," the court of appeals observed that these were "readily disposed of." *Id.* at 44; App. 26. Gurary's theory as to these claims was that he made them *after* he had been fully informed of the manipulative short-selling scheme; indeed, after, according to him, Feigenbaum had confirmed the existence of Winehouse's scheme and had assured that Nu-Tech would refuse to register the common shares into which Winehouse's preferred shares were convertible,

"thus preventing [Winehouse] from covering his short position . . . and thereby perhaps deterring further short selling." *Id.* at 45; App. 26.

The court of appeals noted that "[i]n consequence, Gurary made each of these purchases in the belief that the prices he paid reflected Winehouse's allegedly manipulative activities." *Id.*; App. 26. As a result, these claims were properly dismissed because Gurary failed to plead and prove either that he was deceived, or that he relied—he failed to plead or prove that his trades were made "in ignorance of the fact that the price was affected by the alleged manipulation." *Id.*; App. 27. The claims were thus lacking in two of the foundation elements of a Rule 10b-5 claim, deception and reliance.

With respect to Gurary's initial purchases of Nu-Tech shares, on October 31, 1996, and November 6, 1996, which the court of appeals addressed next, the court similarly held that these claims were fundamentally deficient under the Securities Exchange Act of 1934. Because Gurary's own theory was that the alleged manipulation began *after* November 6, 1996 (the earliest date on which Winehouse and others acquired the convertible preferred), "any deception inherent in the execution of a manipulative scheme beginning on or after November 6 was not 'in connection with' [Gurary's] purchase on October 31." *Id.;* App. 28 (citing *Samuel M. Feinberg Testamentary Trust v. Carter*, 652 F. Supp. 1066, 1080 (S.D.N.Y. 1987)). Thus, that claim was properly dismissed.

The claim relating to the November 6 purchase fared no better. It was likewise flawed, "as the very fact that Gurary was a buyer in a market allegedly depressed

by a manipulative scheme is an insurmountable obstacle to his claim based on that purchase." *Id.* at 45-46; App. 29. As the court of appeals held, "[w]here, as here, a buyer pays less for a security by reason of a defendant's fraud or manipulation, there is no excess of price over value, so the buyer may not recover." *Id.* at 46; App. 30. As the court declared, "that is no more than a common sense application of Section 28(a) of the [Securities] Exchange Act [of 1934]. . . . " *Id.*

Finally, having affirmed that court's dismissal of the complaint in all respects, the court of appeals turned to Nu-Tech's cross-appeal from the district court's denial of sanctions. Apparently reading the district court's first sanctions order as "merely formalistic" (App. 36), the court of appeals held that the district court had failed to make "findings regarding compliance with Rule 11(b)" and thus remanded "in order to permit it to do so." *Id.* at 47; App. 33.

D. The Decision of the Court of Appeals in *Gurary II*.

On remand to the district court after *Gurary I*, that court adhered to its prior decision denying sanctions (App. 35-38), and Nu-Tech filed a second notice of appeal to the United States Court of Appeals for the Second Circuit. By published opinion dated December 19, 2000, the court of appeals affirmed the determination of the district court with respect to sanctions in part, reversed that determination in part, and remanded once again to that court for further proceedings consistent with its reversal. *Gurary II*, 235 F.3d 792 (2d Cir. 2001); App. 39-65. The gravamen of the court of appeals' holding was that two of Gurary's claims in his complaint, predicated

on two of the four securities trades that were at issue in the case, had violated Rule 11(b).

The court of appeals first noted that Congress had enacted the PSLRA in part to give "teeth" to Rule 11, and pointed to its recent decision in *Simon DeBartolo Group, L.P. v. Richard E. Jacobs Group, Inc.*, 186 F.3d 157, 166-67 (2d Cir. 1999), where it had observed that Congress recognized "the need to reduce significantly the filing of meritless securities lawsuits" and placed added emphasis on the sanctions sections of the PSLRA because "[e]xisting Rule 11 ha[d] not deterred abusive securities litigation." *Gurary II*, 235 F.3d at 797; App. 49. Quoting 15 U.S.C. § 78u-4(c)(3)(A)(ii), the court explained that "[i]f a court finds a Rule 11 violation, 'a rebuttable presumption [arises] that the appropriate sanction for a complaint that substantially fails to comply with Rule 11(b) "is an award to the opposing party of the reasonable attorneys' fees and other expenses incurred in the action."'" *Id.*; App. 49-50.[5]

Turning to the four claims that were urged in this case to have violated Rule 11(b), the court of appeals agreed with Nu-Tech's contention, with respect to those claims arising from Gurary's securities purchases of October 31, 1996, and November 6, 1996, that Gurary had "'failed to satisfy fundamental and threshold

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[5] The court noted that where a party against whom sanctions will be imposed rebuts the presumption by providing sufficient evidence under 15 U.S.C. § 78u-4(c)(3)(C), then the courts are to impose such sanctions as they deem appropriate. *Id.*

requirements for a Rule 10b-5 claim,'" had "'failed . . . to suggest any reason that he could have achieved "success under existing precedents,"'" and had "'failed to advance any "reasonable argument . . . to extend, modify or reverse the law as it stands."' *Id.* at 798; App. 53. The court of appeals rejected Jaroslawicz's arguments that sanctions were not warranted where the "merits" of a complaint are "arguable," and held that "sanctions therefore [are] mandatory." *Gurary II*, 235 F.3d at 799-800; App. 58.

Accordingly, the court of appeals remanded to the district court "to determine appropriate sanctions pursuant to 15 U.S.C. § 78u-4(c)(3)(A)-(C)," noting in this connection that such sanctions were to be imposed against Jaroslawicz and his firm, not against Gurary himself. *Gurary II*, 235 F.3d at 800 n.8; App. 59. Gurary (or, rather, Jaroslawicz and his firm) moved for panel reconsideration and for rehearing *en banc*, and the court of appeals denied that motion by order dated February 28, 2001. The court of appeals' mandate issued March 8, 2001. The petition for a writ of certiorari was thereafter timely filed in this Court on May 29, 2001, and docketed on June 29, 2001. While the petition for the writ was pending, the district court rejected Jaroslawicz's further arguments why sanctions should not be imposed against him, and by written decision and order dated August 1, 2001, imposed sanctions in the amount of $62,556.28. *Gurary v. Winehouse*, 97 Civ. 3803 (LLS), 2001 WL 876912 (S.D.N.Y. Aug. 2, 2001).

REASONS FOR DENYING THE WRIT

The petition's factbound claim that the court of appeals erred by awarding sanctions for the assertion of frivolous claims does not warrant review by this Court. The court of appeals' decision in *Gurary II* was a plainly correct application of settled principles of liability and damages in the jurisprudence of Rule 10b-5, most of it emanating from this Court and not subject to serious doubt. The determination to award sanctions was based on a plainly correct reading of a clear federal statute, the Private Securities Litigation Reform Act of 1995, that raises no issues of interpretation, overbreadth, or constitutional infirmity that would warrant review in this Court. Similarly, no conflict, substantial or otherwise, among the circuit courts or with a decision of this Court is urged in the petition. Nor is there any serious departure from the accepted and usual course of judicial proceedings that would warrant this Court's attention, or any important question of federal law that should be settled by this Court. The specific reasons that support these conclusions follow below.

1. Both in affirming dismissal of Gurary's claims and in determining that sanctions should be imposed against his counsel because the complaint he had signed had "'failed to satisfy fundamental and threshold requirements for a Rule 10b-5 claim,'" had "'failed . . . to suggest any reason that he could have achieved "success under existing precedents,'" and had "'failed to advance any "reasonable argument . . . to extend, modify or reverse the law as it stands"'" (*Gurary II* at 798; App. 53), the court of appeals relied solely on settled principles of securities law.

2. The court of appeals held that the fundamental, threshold elements of a Rule 10b-5 claim, deception and reliance, were absent; that the fraud alleged was not "in connection with" Gurary's purchases of Nu-Tech shares; and that Gurary had sustained no cognizable and recoverable damages under the securities laws, that he had not alleged or proven any "excess of price over value." There is no occasion to revisit the principles on which these holdings were based, as they are a well settled part of the body of federal law. *See, e.g., Acito v. IMCERA Group, Inc.*, 47 F.3d 47, 52 (2d Cir. 1995) (to make out a claim for fraud under Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder, a plaintiff must allege that "in connection with the purchase or sale of securities, the defendant, acting with scienter, made a false material representation or omitted to disclose material information and that plaintiff's reliance on defendant's action caused [plaintiff] injury.")

3. Nor does Jaroslawicz suggest that in relying on these principles in the context of awarding Rule 11 sanctions, the court of appeals' decision brought it into conflict with any decision of this Court, or any decision of any other court of appeals. To the contrary, the law of sanctions is a relatively well settled body of law, unaffected by inter-circuit or other disharmonies. *See, e.g., Simon DeBartolo Group, L.P. v. Richard E. Jacobs Group, Inc.*, 186 F.3d 157 (2d Cir. 1999); *Eastway Constr. Corp. v. City of New York*, 762 F.2d 243 (2d Cir. 1985).

4. Similarly, Jaroslawicz suggests no reason that this Court should grant the writ in order to interpret or assess Congress's directives under the Private Securities Litigation Reform Act of 1995, 15 U.S.C. § 78u-4 *et seq.*

(the "PSLRA"). While that act may indeed have modified former practice with respect to securities litigation, there is simply nothing about it with respect to the sanctions provisions that would require, or even argue, that this Court grant certiorari to review it. Equally, there is nothing to suggest that any district court or court of appeals has found any difficulty in applying the PSLRA, or in assessing the need for sanctions thereunder, so as to mandate review here.

5. Rejecting these traditional bases for review by certiorari, Jaroslawicz's sole argument is that this Court should correct a *factual error* that he claims was committed by the court of appeals. Even assuming that such an error merited review here (it does not), no such error was committed. The argument, in simple terms, is that Jaroslawicz never intended to plead that Nu-Tech was liable for securities fraud with respect to the securities purchases of October 31, 1996, and November 6, 1996, but only with respect to those that occurred on December 24, 1996, and February 18, 1997. He therefore contends that when the court of appeals determined that the claims predicated on the earlier two trades, but not the latter two, were sanctionable because they could not be supported in law or in fact, the court committed error.

6. In the first instance, such an error, if it was committed (it was not), is irrevocably bound up with the manner in which his pleading sought to present the claims, and with the manner in which Jaroslawicz sought to defend that pleading in the district court and the court of appeals. Thus, the error if any, was factbound, and is tied to the specifics of the matter before those courts. It does not raise any general

principle of law that is within the traditional jurisdiction or interest of this Court. Its correction (even assuming it needed any) would have no effect on any person other than Jaroslawicz. Such an error, if committed, was one that the court of appeals could easily have ascertained and corrected. That it did not do so on rehearing—after Jaroslawicz finally, and belatedly, pointed out this supposed error—necessarily forecloses further review here.

7. Moreover, Jaroslawicz would have this Court conclude that the court of appeals misread not only the complaint in this action, but all of the briefs that were before it, as well as counsel who argued before it twice. He asserts that the 10b-5 claim he himself drafted, based on the four separate securities purchases that he identified in the complaint, was in actuality intended to have been separate claims as against separate defendants, although in drafting his complaint, in opposing dismissal, in defending himself against sanctions under Rule 11(b), and in presenting his positions to the court of appeals on two plenary appeals, he failed to raise this argument. (As noted above, Jaroslawicz first raised this assertion on petition for rehearing and rehearing *en banc*.)

8. Any fair reading of the complaint discloses that Jaroslawicz had asserted a single, unitary claim arising from the four individual purchases of securities. The complaint did not separate the claims by each purchase of securities, or otherwise differentiate as to which transaction was supposedly actionable as to each defendant, and to the extent that it created ambiguity or uncertainty by reason of poor draftsmanship, that is a risk that Jaroslawicz, the author of this pleading,

necessarily bore. Jaroslawicz contends before this Court that "[n]owhere in the plaintiff's compliant (sic) did the plaintiff allege that a claim was being asserted for each of these purchases" (Petition at 6), yet a fair reading of the complaint discloses the contrary—because the pleader elected to include as operative facts the four separate securities purchases, he intended that opposing counsel understand the pleading to state claims based on each purchase. It simply does not avail Jaroslawicz now to claim that he did not mean this, not after years of proceedings based on a different common understanding.

9. Jaroslawicz contends variously that "[*Gurary I*] specifically noted that the claims against Nu-Tech were limited to the second two purchases, and that no claim was made against Nu-Tech with respect to the first two purchases" (Petition at 7); that the award of sanctions in *Gurary II* based on Gurary's earlier securities purchases is "disturbingly incongruous" because "another panel of the Second Circuit had found that '[p]laintiff's attack on the dismissal of his Rule 10b-5 claims against Nu-Tech *is limited to the claim that he was deceived in making his December 24, 1996 and February 18, 1997 purchases*" (*id.* at 10 (emphasis supplied by counsel in petition)); that *Gurary II* "held that [counsel] must pay sanctions . . . for supposedly having asserted claims that *Gurary I* recognized were not asserted against the defendant Nu-Tech" (*id.* at 11); and that the holding of the court of appeals in *Gurary II* is "contrary to what the [court of appeals] held in *Gurary I*." *Id.* at 19.

10. These contentions—that there is a fatal variance between the decision in *Gurary I* and the decision in *Gurary II*—are, however, without any merit whatsoever, and are based on a plain misreading of the decision in *Gurary I*. Thus, in noting that "[Gurary's] attack on the dismissal of his Rule 10b-5 claim against Nu-Tech is limited to the claim that he was deceived in making his December 24, 1996 and February 18, 1997 purchases" (*Gurary I*, 190 F.3d at 44; App. 24), the court of appeals was neither parsing the complaint to determine what Jaroslawicz had in fact sought to plead, nor indicating in any manner that his *claims* and pleading were limited in such a fashion. Rather, the court of appeals was merely acknowledging the fact that while in the district court Gurary and his counsel had sought to defend *all* of the claims from attack under Fed. R. Civ. P. 12(b)(6) and 56, in the court of appeals he had "limited" his arguments, and had "abandoned any other claims against Nu-Tech . . . ." *Id.* and n.7.[6]

11. In short, on appeal in *Gurary I* Gurary and his counsel failed to defend the earlier securities purchases as stating claims for relief. Instead, on the first appeal Gurary and his counsel abandoned their prior theory as to Nu-Tech (that Nu-Tech know of, but failed to disclose,

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[6] The contention that there is a fatal variance between *Gurary I* and *Gurary II* is repeated several times throughout the petition (*see, e.g.*, Petition at 10, 17), as if the court of appeals had in fact explicitly recognized the variance. It did no such thing, and the effort to make it seem as if it had done so is misleading in the extreme.

the scheme), and substituted a different one—that Nu-Tech had promised to frustrate the scheme, and did not keep its promise. But this change of theory cannot alter the original, frivolous allegations as to which the court of appeals imposed sanctions.

12. To the extent the petition argues that the court of appeals erred, that is a mere factual argument, not an assertion that there is any fundamental and important conflict in federal law that requires this Court's intervention. Stated otherwise, and even assuming that the court of appeals was wrong (it was not), it is axiomatic that an error in the application of a settled rule alone does not bring this case within the ambit of Supreme Court Rule 10. As that rule states, "[a] petition for a writ of certiorari is rarely granted when the asserted error consists of . . . the misapplication of a properly stated rule of law." Sup. Ct. R. 10; *see Hubbard v. United States*, 514 U.S. 695, 720 (1995) ("A high degree of selectivity is . . . enjoined upon us in exercising our certiorari jurisdiction . . . . [O]rdinarily a court of appeals decision interpreting one of our precedents—even one deemed to be arguably inconsistent with it—will not be reviewed unless it conflicts with the decision of another court of appeals.") (Rehnquist, C.J., dissenting).

13. Jaroslawicz's many assertions that the court of appeals' imposition of sanctions will have an "*in terrorem* effect" (*see, e.g.*, Petition at 11, 18) on "lawyers whose clients have valid securities fraud claims" (*id.* at 11), are equally without merit. No lawyer need fear to assert a *valid* claim. That, of course, is the clear command of the Federal Rules of Civil Procedure and of the PSLRA. Jaroslawicz, contrary to his repeated contentions, was sanctioned for asserting claims, and

repeatedly defending them, that were patently *invalid*—that had no basis in law or in fact. The two decisions of the court of appeals here admit of no other interpretation.

14. Jaroslawicz's *post hoc* rewriting of history fails to assist his arguments. Thus, his petition seeks at length to explain why he included the "details" of his client's securities purchases, yet did not make sanctionable allegations of fact and law. According to Jaroslawicz now, this was "by way of background," and "to demonstrate that [Gurary] was a legitimate investor whose interest in [Nu-Tech] pre-dated the fraud, rather than the sort of faux (sic) investor" whose "speculative" securities purchases for litigation purposes the PSLRA was designed to intended to discourage. Petition at 13. This wholesale rewriting of history fails to account for two salient facts—the utter absence in the complaint of any indication that this was the reason for the inclusion of these facts, and the context of the pleading, which indicated, exactly to the contrary of these contentions, that these facts were included because they were operative facts giving rise to purported claims.[7]

15. Finally, *Gurary II*, while it plainly stands as a warning against the filing of frivolous claims, does not in

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[7] Nor need lawyers avoid providing "detail" and "background information" in their complaints for fear of being sanctioned. The pleading standards are well settled ones. *See* Fed. R. Civ. P. 8, 9(b). Those standards are not in issue in this case, and were not at issue before the court of appeals.

any manner indicate that securities practitioners should hesitate to file meritorious claims because their pleadings will be "microscopically scrutinized" in order to "find 'frivolous' statements." (Petition at 19) Securities pleadings will be held to the same standard to which they have always been held, pursuant to the adjectival prescriptions of the Federal Rules of Civil Procedure and the substantive admonitions of the securities laws. Nothing in this case alters this regime. The case stands as fair warning that securities practitioners must scrutinize their pleadings so that the Rule 11 warranty that allegations are "well grounded" in fact and law is a meaningful one. Complaints that fail to satisfy this requirement, and practitioners who fail to advance reasons that their pleadings could achieve success under existing precedents or reasonable arguments to extend, modify or reverse the law, are properly subject to that warning.

16. In short, there is no conflict on an important matter between any decision of this Court and the decisions of the court of appeals here. There is no conflict on an important matter between decisions of the courts of appeals that is raised by this petition. And there is no challenge to any action of the court of appeals in the nature of an assertion that they have "so far departed from the accepted and usual course of judicial proceedings . . . as to call for an exercise of this Court's supervisory powers." Sup. Ct. R. 10(a). The petition at best seeks a further level of appellate factual review that is unavailable in this Court; all proper and traditional bases for the exercise of this Court's certiorari jurisdiction are lacking.

CONCLUSION

For the reasons given above, the Court should deny the petition for a writ of certiorari.

Respectfully submitted,

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